EFFECTS OF SOUTH KOREAN MARKET LIBERALIZATION ON THE SOUTH KOREAN RETAIL MARKET

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(ABSTRACT)

South Korea is a country that is poor in natural resources and capital and remains behind many other nations in technological development; however, South Korea's unique development strategy has led its economy to high growth over the last three decades. During 1997, South Korea began to experience a serious financial crisis, including bankruptcies of many of its conglomerates, a drastic depreciation in the international exchange rate of the South Korean currency, and an increasing foreign debt. Currently South Korea is struggling to compete with products from both industrialized nations and newly industrializing nations. The current crisis has occurred as South Korea has been engaged in extensive market-opening.

Knowledge is lacking about South Korea's intricate and rapidly changing political and economic climate. The purpose of this research was to explore and clarify the interrelated factors that have contributed to South Korea’s present economic problems, especially those facing South Korea’s retailing industry.

The qualitative methodology of "grounded theory" was used in this study. Grounded theory is a general methodology for developing theory that is grounded in data which are systematically gathered and analyzed. Theory evolves during the research process through a continuous interplay between analysis and data collection.

This research attempted to discover the factors, or themes, that have affected the South Korean economy and retailing industry. The following factors were identified: (1) foreign direct investment; (2) the price-gap between imported goods and domestic products; (3) South Korea's trade deficit; (4) perceived over-consumption of luxury items by South Korean consumers; and (5) the chaebol, or South Korean large conglomerates.

The economic factors that have led to the current difficulties facing the South Korean retailing market are complicated and interwoven. South Korean retailers will have to address these factors in the future, and attempt to find solutions. It is hoped that the knowledge resulting from this will be of benefit to South Korea's attempt to compete in a global marketplace.

DEDICTAION

To my parents, Jin Ky Hwang and Ki Ja Hwang
and to my friends

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CHAPTER I

INTRODUCTION

Origin and Importance of the Study

South Korea is a country that is poor in natural resources and capital and has lagged behind many other nations in technological development. As late as 1961, South Korea suffered from many of the difficulties facing less developed countries today. In addition to its extreme poverty, the population was growing by 3% annually, and unemployment and underemployment were pervasive. Domestic savings were negligible. Korea had no significant exports and depended on imports for both raw materials and most manufactured goods ("The Economic Policy," 1995). Starting in 1960s, however, South Korea formulated a unique development strategy that led its economy to high growth over the last three decades. The South Korean government's strategy has included protecting the domestic market and providing financial support to encourage companies to invest in facilities and technology development. South Korea has grown to be the world's twelfth largest economy, with world-class competitiveness in certain sectors, while its large conglomerates, or "chaebol," have continuously worked to become international competitors.

Historically, South Korea had closed its major retailing operations to foreign ownership. And further, South Koreans have been taught from youth that exports are good and imports are bad for the economy. Exporters have been treated well and importers have not. Foreign trade officials have been caricatured or even attacked in effigy. For the past three decades, South Korea has financed its economic development policy through foreign borrowing, while discouraging foreign direct investment (FDI). The market liberalization, effective January 1, 1996, allowed foreign retailers to enter South Korea on their own, or with a South Korean partner unencumbered by the restrictive regulations that for decades kept most sales outlets under the control of South Korean producers. In accordance with South Korea's trade agreements during the negotiations in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), foreign retailers now have greater access to the South Korean market (see Table 1).

Problem Statement

During 1997, South Korea began to experience a serious financial crisis, including bankruptcies of many of its conglomerates, a drastic depreciation in the international exchange rate of the South Korean currency, and an increasing foreign debt. A factor that is said to have greatly contributed to the present crisis is South Korea's agreement to extensive, rather rapid market-opening, and now South Korea is struggling to compete with products from both industrialized nations and newly industrializing nations.

Globalization entails both rights and obligations. For other countries to allow South Korean firms to compete within their borders, South Korea has had to open up its markets as well. According to a report in 1996 by the Korean Institute of Finance, wider market-opening has caused South Korea to run a greater current accounts deficit. The report said that the implementation of liberalization policies had resulted in a sharp increase in imports and a stimulation of consumption, leading to a worsening of South Korea's current accounts imbalance ("In the Shadow," 1996). Local retailers and wholesalers are competing with foreign multinational giants under new circumstances, and moreover, with little protection. Consumers, with tastes for high-quality goods and services, will no longer only patronize local retailers.

Trade liberalization in South Korea has brought adjustment difficulties for the economy in general, and for the retailing industry specifically. Most South Korean retailers have reason to be concerned about the effects of market liberalization because the majority of retailers are small and inefficient family-centered operations, whereas the foreign internationals with which they

Table 1
Chronology of South Korean Retailing Market-Opening

DATE	NAME OF ACT	MAJOR FEATURE
July, 1981	Limited allowance of foreign investment	Allowed a below-333 m^2 store for one-item retailing. (1 Pyong = 3.3 m^2)
October, 1982	Relaxation of the limit	Expansion to 660 m^2.
July, 1984	Lifting of limits on merchandise	Expansion to 700 m^2 and in number of stores.
October, 1988	Announcement of a three-phase plan for market-opening	
January, 1989	1st-phase market-opening	Drastic expansion in technology introduction and in wholesale investment scopes.
July, 1991	2nd-phase market-opening	Allowed up to 10 stores with unit store size below 1,000 m^2.
July, 1993	3rd-phase market-opening	Expansion to up to 20 stores with store size below 3,000 m^2.
December, 1993	Complete plans submitted to GATT negotiators	The government submitted its plans, to GATT negotiators, to completely lift existing restrictions on the number of stores allowed and maximum floor space.
January, 1996	Full market-opening	Full lifting of limits on number and size of stores.
1997	Full market-opening	The local distribution sector was fully opened to foreign retailers.

Note: Complied from Korea: KOTRA to hold active investment promotion activities. (1996, January 17). The Korean Economic Weekly, p. N/A. Korea: Retail distribution market overview. (1996, July 22). International Market Insight Reports. Chamber World Network International, Ltd. Local Retailers brace for a foreign onslaught. (1993, September). Business Korea, 11(3), 53-54.

are now competing are rapidly enhancing their efficiency by adopting computerized and standardized operations systems.

South Korea's traditional stores, consisting primarily of small retailers, are particularly affected by competition from foreign companies. The Korean Institute of External Policy has stated that a full opening of Korea's markets would force 15 %, or 6,200, of its small retailers out of business, and would hurt the less competitive big distributors as foreign concerns gain market share ("World Wire," 1992). A survey by the Daewoo Group economic research center showed that about 70 % of South Korean retailers feared that they would go bankrupt in the wake of liberalization (Yoo, 1996). If South Korea can succeed in self-renovation or self-restructuring, market liberalization will be a great opportunity through which the nation will be able to foster enough competitiveness to contend in the global market; otherwise, the outcome could be damaging for the South Korean economy.

Purpose of the Research

A significant proportion of the retailing industry in South Korea involves apparel. South Korean retailers, including those in the clothing and textiles sector, will have to address the difficulties brought about by the increased participation of the nation in the global economy, and attempt to find solutions.

South Korea has been heavily engaged in international trade for many years, and has enjoyed the benefits of a market that was protected from the competition of foreign imports and investors; however, the economic climate of South Korea is undergoing a process of rapid change as the nation strives to compete more fully in the global arena of trade. South Korea’s internationalization, including the opening of the South Korean market to international trade and foreign investment, may have contributed to the country’s economic crisis. The market-opening that has occurred in South Korea reflects the political-economic factors of both pressure from abroad and momentum from within; these factors are complicated and interwoven. The purpose of this research is to explore and clarify the interrelated factors that have contributed to South Korea's present economic problems, especially those facing South Korea's retailing industry. It is hoped that a better understanding of these interrelated factors, or themes, will contribute knowledge that will be of benefit to South Korea's attempt to compete in a global marketplace, and will help to provide a foundation for further investigations.

The Need for the Research

Strong conservative forces ensure a degree of continuity in the retailing systems of developing countries, but equally strong rapid changes are taking place resulting mainly from what some call modernization of the retailing industry through importing western retail institutions and western types of consumer behavior (Paddison, Findlay, & Dawson, 1990). Retailing in South Korea is a relatively unexplored field of study. The study of retailing systems in South Korea encompasses a wide range of environments related to the importance of local, often culturally embedded factors, in combination with the impacts of external factors.

Unfortunately, the present knowledge about the retail environment in South Korea seems to be incomplete, indistinct, and somewhat contradictory. Generalizations from studies of other emerging economies may not apply due to differences between and within the emerging economies. Consumer and business censuses are often lacking or unsophisticated; there is little market research; trade directories and other business data services are likely to be scarce. For example, the demarcation between wholesale and retail is particularly unclear in the developing countries. The proprietors of the smallest shops, who, from a Western viewpoint, would seem to have exclusively retail businesses, often make many of their sales to even smaller dealers who trade in the streets, in the marketplaces, or in the rural areas.

Analysts have shown less interest in studying distribution in developing countries, such as South Korea, than they have in investigating production. Researchers in the economically advanced nations have paid relatively little attention to promoting an understanding of how retailing operates in the developing nations, such as South Korea, compared with their volume of work on other economic sectors (Kaynak, 1982). One aspect to which researchers have paid particular attention is the relationship between retailing and economic development, in terms of the efficiency of the distribution network; however, usually the relationship has been explored in terms of the marketing system as a whole, including wholesalers and agents, as well as retailers (Galbraith & Horton, 1955; Mittendorf, 1981; Ortiz-Buonofina, 1987; Walters, 1994; Williams, 1997). Therefore, there is a need for research that focuses on South Korea's specific economic circumstances and on its retailing market.

Organization of the Thesis

This thesis is organized as follows. Chapter I comprises the origin and importance of the study, the overall purpose of the study, including its broad objectives, and the need for the study. Chapter II is Part 1 of the literature review and presents a theoretical and methodological background for this research. Due to the scarcity of contemporary studies on South Korean retailing and liberalization, the literature reviewed in that chapter focuses primarily on more general empirical and theoretical studies about developing countries and retailing. Chapter III constitutes Part 2 of the literature review and comprises a chronological, general context for the research and a summary of influences on South Korea’s economy and retailing industry. Chapter IV outlines the methodology used in the research, including a discussion of the qualitative method of "grounded theory" developed by Glaser and Strauss (1967, 1970), the economic development of South Korea as a case study, data collection and analysis, themes discovered during the development of this research, the research questions, and the limitations of the research. Chapter V describes the characteristics of South Korean retailing. Chapters VI, VII, and VIII comprise elaborations of the themes, which include, respectively, the effects of “over-consumption” by South Korean consumers (Chapter VI), the effects of rapid modernization, including effects of foreign direct investment, the trade deficit, and the price gap between imports and local goods (Chapter VII), and the effects of "chaebol," or large conglomerates (Chapter VIII). Chapter IX is the concluding chapter, and also presents recommendations for future research.

CHAPTER II

LITERATURE REVIEW PART I: THEORETICAL AND METHODLOGICAL BACKGROUND

The economy of South Korea is undergoing rapid change, and the effects on retailers of the opening of South Korea's markets to international trade and investment have yet to be determined. Much of the research on South Korea's marketing focuses on the role of marketing in development, in general, instead of contributing to a better understanding of the effects of liberalization on these markets and to formulating plans, systems, and processes applicable to South Korea (Wood & Vitell, 1986). It must be understood that retailing, which is the focus of this research, is one component of the larger picture of national economic activity, and that in South Korea retailing is in a state of flux due to many external and internal factors. These factors include the traditional patterns of retailing in South Korea; importing activities by South Korean entrepreneurs; the currently high levels of South Korean consumers' purchasing, perceived as over-consumption; competition with foreign direct investment; South Korea's trade deficit; and the effects of the "chaebol," or large conglomerates, upon retailing. Because there is little contemporary literature upon which to draw for this study, it was necessary to look to theories of market liberalization and liberalization's effects on developing countries in order to provide a general perspective on liberalization that would serve as a backdrop for this research.

Recently, a body of literature has developed which begins to establish a theory of market liberalization, and which explores the factors that contribute to a government's economic success in adapting to liberalization and in creating the interest groups necessary to sustain it; however, this literature is significantly lacking in empirical verification (Collier, 1993). Due to the scarcity of contemporary, scholarly work on this topic, it was necessary to examine work that addresses some of the larger issues that impact retailing in South Korea and that are discussed in this study. Although none of the published studies focuses directly on South Korea, the studies are of value in providing a general context to the economic crisis currently facing South Korea. Due to the fact that trade liberalization is very recent in South Korea, there is a lack of research that measures the results of market-opening on retailing in that nation. Studies reviewed in this chapter relate to the topics of the characteristics of retailing in South Korea and to problems in South Korean retailing.

This chapter reviews literature that illuminates some of the methodologies used to investigate market liberalization, in both empirical and theoretical research. Next is a review of the general literature on the topic of market-opening in developing countries, organized into the following topics: liberalization and trade regulations, market-opening and interest group politics, foreign direct investment in developing countries, and retailing and the internationalization process. The chapter concludes with a review of literature that deals more specifically with South Korea's trade liberalization and its effects. Much of the literature directly relating to this study consists of recent accounts of South Korea's rapidly changing situation, and includes magazine and newspaper accounts. These accounts may provide anecdotal data about contemporary events, but they tend not to be empirically based. Scholarly studies reviewed here that relate to the South Korean context include ones on South Korean market-opening strategies and problems in South Korean retailing.

Trade Liberalization in Developing Countries

The liberalization of trade in developing countries has become a global phenomenon. The specifics of trade liberalization may not be the same from country to country, but the liberalization of trade usually indicates that competition is being promoted where formerly trade was subject to strictly enforced controls (Kay & Silberton 1984). As a term, "liberalization" is widely used but not clearly defined in the literature (Do Rosario, 1988; Gillespie, 1984; Kay & Silberton, 1984). "Trade liberalization [can be] defined as any act that would make the trade regime more neutral - nearer to a trade system free of government intervention. Such acts may take two forms: changes of price instruments – primarily tariffs – and relaxation of quantitative restrictions" (Mickaely, Papageorgiou, & Choksi, 1991, p. 13).

First, it is important to understand why so many nations in different parts of the world, at different stages of development, and having diverse economic systems have initiated steps toward liberalization. It is necessary for nations to compete aggressively for international investment if they are to succeed economically. International investment greatly contributes to how production, jobs, profits, and technology will be distributed worldwide. The particulars of countries' individual strategies and the timing of their liberalization initiatives can be explained by the specific circumstances of the various nations; however, the rise in global interdependence is making it necessary for all countries to initiate trade liberalization to remain competitive in a global marketplace, regardless of those countries' prior philosophies or policies. Countries' offerings of direct incentives usually facilitates foreign investment, but open markets are essential to achieve the investment (Bergsten, 1996).

Various methods have been used to investigate the implications of trade liberalization, but these methods can be grouped into two primary types: those in empirical studies, and those in studies that generate theory. The next two sections of this chapter describe examples of empirical and theoretical methods in studies used to investigate trade liberalization in developing countries.

Methods in Liberalization Research

Empirical Studies

The fundamental step in an empirical study of market liberalization is to measure that liberalization. This is extremely difficult: trade restrictions have partly qualitative components which must be converted into their price equivalents, and a summary scale or instrument must be aggregated from the many different implicit and explicit subsidy and tariff rates. Given the scope of the potential data, it is necessary to make selections among alternatives.

In general, there have been two broad approaches to empirically evaluating the economic effects of market liberalization: cross-country studies, and time-series studies. Cross-country studies can be characterized as “with-without,” and “before-after.” Examples of “with-without” studies are ones conducted by the World Bank (1990) and by Mosely, Harrigan, and Toye (1991a, 1991b). This approach involves taking a sample of countries subject to trade reforms and comparing them to countries that are not subject to trade reforms, and then attributing any differences in their performance to the reform program. “Before-after,” also used by the World Bank (1990) and Mosely, Harrigan and Toye (1991a, 1991b), compares economic performance for a few years before and a few years after trade liberalization.

Marketing and consumer researchers doing cross-country studies usually use mail surveys to collect data (Douglas & Shoemaker, 1981; Green & White, 1976), because mail surveys are not as expensive or time consuming as collecting data from interviews, do not require trained personnel to administer, can be used to reach widely separated populations, and can collect a greater volume of data. They can be used to collect data from respondents such as soldiers, farmers, and busy executives who otherwise might be difficult to contact. For these reasons, the mail survey is usually the data collection method of choice for researchers in business and academia (Watson, 1965). This method is also free from interview bias or variability (Boyd & Westfall, 1955; Frankel, 1960). Some of the difficulties that can be associated with surveys in general are a high non-response rate and the non-response bias (Jobber, Mirza, & Wee, 1991; Yu & Cooper, 1983). These problems are especially critical in cross-national mail surveys (Brislin, Lonner, & Thorndike, 1973).

High levels of illiteracy in the target populations may pose a problem for cross-country data collection, in addition to the difficulties caused by poor mail service and non-availability of the sampling frames. However, in many industrial populations, mail surveys of business personnel are successful, because sampling frames are available (Douglas & Craig, 1983). A potentially low-response rate is the primary problem facing the researcher attempting to gather cross-country data on marketing, in that a target population of business personnel tends to generate a much lower rate of response than a household population (Jobber & Sanders, 1986). Increasing the rate of response from business personnel in domestic markets is a primary goal of those conducting research that utilizes mail surveys (Ayal & Hornik, 1984; Keown, 1985).

The individual country study has the advantage of being able to record change over time, and usually has a high information content. This type of study is useful as a valuable source of historical data and documentary detail about a particular country. The individual country study may combine historical information and data series, particularly time-series data, thus providing useful contextual and background information. Retailing has recently undergone rapid change, and is likely to continue to evolve in the future. An individual country study would allow the researcher to investigate in detail the changes in retailing and other industries brought about by episodes of liberalization. According to Heidi and Wortzel (1987), the entire consumer goods distribution system, as well as manufacturing of consumer goods, can be affected by changes in retailing.

Theoretical Studies

In recent years, there has been a renewed interest in American and European international retailing. Much of the literature that has been produced as a result of this interest focuses on the strategic components of expansion, and is based on longitudinal tracking, historical evidence, and the use of data from empirical studies.

Gillespie and Alden (1989) used a longitudinal tracking study in their theoretical work, and concluded that there is a liberalization life-cycle in consumer product imports in developing countries (See Table 2). “A longitudinal study is the continuation of the relationship between the

Table 2

Consumer Product Export Opportunities to Liberalizing LDCs: A Life-Cycle Approach

Stage	Policies	Market Characteristics	Foreign Exporter Opportunities
Pre-Liberalization	Encouragement of import substitution. Severe restrictions on consumer imports. Possible production limitations on consumer products. Heavy taxation on consumption and/or upper incomes: discouragement of conspicuous consumption.	Seller's market. Restricted competition. Pent-up consumer demand.	Very restricted.
Liberalization	Greater encouragement of free enterprise and competition. Encouragement of export orientation. Allowance of wider income disparities.	Greater availability of consumer products. Wider choice of products. Increased spending on consumer products.	Substantially increased.
Partial Restriction	Reenactment of higher tariffs and quotas and/or decreased importer access to foreign exchange. Reenactment of import substitution.	Slower consumption growth likely. Competition from local production.	Possibility of curtailment or threats to continued access via foreign investment.

Adapted from "Consumer product export opportunities to liberalizing LDCs, a life-cycle approach," by K. Gillespie and D. Alden, 1989, Journal of International Business Studies, 20(1), p.98.

investigator and subject over an extended period of time, even many years" (Touliatos & Compton, 1988, p. 492). Gillespie and Alden (1989) found that government policies greatly restrict consumer product imports during the pre-liberalization phase, and then economic liberalization policies boost such imports. They hypothesized that, after markets have been liberalized for several years, modification of policies produces a partial retraction of free trade measures. The retraction may result from problems with the balance of trade and may be temporary, or may be longer-term, as the result of a rethinking of priorities. In the retraction phase, governments may be more liberal in allowing access of both local and foreign investments in domestic markets. Foreign investment may be more attractive to governments having problems with balance of payments. In fact, governments facing balance of payments problems may consider foreign investment more attractive than before, when the country did not have a balance of payments problem. Although slower consumption growth is likely during the retraction phase, foreign exporters may still find a re-protected market sufficiently attractive to warrant direct investment or licensing.

Of particular interest in adding to the knowledge base on the effects of liberalization on developing countries is the extensive study edited by Papageorgiou, Michaely, and Chosky (1991), entitled Liberalizing Foreign Trade. In this 300-page, 7-volume study, the editors included analyses of 36 liberalization events. The study is the most comprehensive cross-country study on the subject to date. In this work, the editors analyzed the reports, by 28 authors, of 36 liberalization events. The editors take the position that there is a clear correlation between trade orientation and economic performance. Because of the liberalization currently occurring in many developing countries, the work is potentially of great interest from the viewpoint of policy; however, Liberalizing Foreign Trade has been criticized in terms of its methods (Collier, 1993). According to Collier (1993), as a source book, it complements theory but does not actually advance it. The work has been cited for its lack of an analytical framework. Instead, it oversimplifies cause and effect in terms of predicting the success or failure of liberalization attempts, or of predicting the most successful sequence of reform. Also, the work has been criticized for not generating easily identifiable patterns, and for not applying data to specific theories. However, Collier (1993) suggested that the book might be valuable as a source book for evidence which could be used to test theories.

A research direction that requires more attention in the future is that of broadening our understanding of the process of companies' internationalization. A study by Johanson and Vahlne (1977) deals with an aspect of this issue. The authors hypothesize that internationalization is an incremental process, the rate of which is determined by managers' experiential knowledge of foreign markets, thus linking the process to organizational factors. Vernon (1966), Johanson and Wiedersheim-Paul (1975), Cavusgil (1980), and Luostarinen (1980) supported this hypothesis, outlining sequential steps in the process. The first stage is expansion from the domestic market into those markets that match the cognitive and resource character of a company in terms of language systems or finance. Further expansion does not take place until organizations overcome barriers in those markets where "psychic distance" is least - psychic distance being the degree of uncertainty about operations in foreign markets. This experiential learning is a cornerstone of future expansion. Denis and Depelteau (1985) supported the view that internationalization begins with psychologically proximate countries. Cavusgil (1980) adds weight to this hypothesis from studies carried out in the U. S. It should be noted that South Korea follows this pattern, in that the internationalization of South Korea's companies began in proximate countries such as Japan.

Porter's Competitive Advantage Theory

In traditional marketing theory, competition in business is regarded as static, and success or failure hinges on production factors. Modern competition is dynamic: technologies, new products, new market demarcations, new production processes, and new management concepts are constantly emerging to change and even undermine a national or industrial competitive advantage. Over the past dozen years, Michael Porter has published three books on "competitive advantage." The first two focused on industry, and the most recent concerns competitive advantage and nations. The changed emphasis is quite meaningful. Porter discovered that a nation's macroenvironment crucially affects industrial competitiveness; it can either help or hinder industrial development. He pointed out that national and industrial competitiveness directly correlate with how the nation stimulates industrial improvement and innovation. After spending three years comparing the industrial development of ten nations (the United States, Germany, Sweden, Switzerland, Denmark, Italy, the United Kingdom, Japan, South Korea, and Singapore), Porter proposed his well-known "Diamond Theory." He argued that two sets of determinants affect industrial competitive advantage and, despite the rapid change of strong globalization, the importance of these factors in determining national competitive advantage has not diminished, but in fact has become more definite (Porter, 1985).

Liberalization: Trade Regulations

This section comprises a discussion of the literature concerning liberalization and trade regulations. Mickaely, Papageorgiou, and Choksi (1991) argue that trade liberalization can be accomplished through one of two routes: either a switch away from quantitative restrictions to tariffs, or a change in relative prices associated with a reduction in the average level and distribution of rates of protection.

With the onset of economic liberalization, imports in general are likely to increase. If industry is being rejuvenated and foreign investment encouraged, a surge of capital and industrial imports is likely. This is because industrial policy accompanying liberalization typically requires such inputs, at least in the short term, and it is reasonable to expect governments to allow them. Renewed government restrictions and/or increased competition from local production may threaten the early growth of consumer import markets. Furthermore, importer access to foreign exchange may also be restricted several years into economic liberalization. As is the case in South Korea, overall import growth is likely to exceed that of exports during the early stages of liberalization due to increased imports for renewed industrialization, i.e., capital and industrial goods and raw materials. Previously liberalizing governments may respond by modifying earlier liberalizing policies, particularly by re-restricting imports not deemed critical to the success of present policy. Consumer imports may be termed "luxuries" under these circumstances (Gillespie, 1984; Thorelli, 1987).

The key role of the foreign trade sector has stimulated a great deal of interest in the links between trade and growth, with the links between trade orientation and exports and between exports and growth receiving particularly close attention (Agarwala, 1983; Bevan, Collier, & Gunning, 1991; Collier & Gunning, 1992; Greenaway & Nam, 1988; Greenaway & Reed, 1991). Alongside the time-series work of the authors just cited, there have been a number of multi-country studies of trade policy in developing countries (Balassa, 1982; Krueger, 1981).

The literature on strategic trade policy suggests that a profit-shifting policy is a trade policy option under a monopolistic market structure (Grossman & Richardson, 1985). Because the market-opening pressure by the government can be viewed as an instrument of profit-shifting policy similar to export subsidies, the demand force in this framework should reflect the underlying rationale for strategic trade policy. For the supply forces, market-opening is the inverse of protection if the foreign demand forces are controlled. If market-opening is considered a "supply force," then it can be seen as the opposite of policies that protect trade. Domestic pressure for trade-protection is seen as the "demand" side of the equation. In the situation where the demand for and/or the supply of the protection gets stronger, the supply of the opening will tend to be weaker, other things being equal, and vice-versa.

Market-opening and Interest Group Politics

Market-opening can be investigated within the framework of public choice, in that it is to the international public good not to exclude some consumers. Specifically, it is useful to analyze market-opening within a framework of interest group politics and positivist economic theory. South Korea's market-opening can be seen as a response to political and economic factors that reflect external and internal pressures. Jwa (1988) investigated the factors that drive market-opening by using a supply and demand framework. Equilibrium between supply and demand has been used, explicitly or implicitly, as a theoretical approach to market protection. Market protection includes the protection of firms from open competition through the use of tariffs, quotas, and other means. This protection may not be based on the need to reduce unfair competition, but may be because the protected products are equal in efficiency or design to those of their competitors (Douglas, 1997). Lavergne (1983) has criticized protection theory by suggesting that the attainment of equilibrium in supply and demand may be impeded by many factors, including a tendency of a government to take a conservative approach to the status quo.

In modeling the process of market-opening, it has been suggested that market-opening occurs as a result of international pressure. Demand is linked to foreign demand forces, and supply involves an inverse process of import protection. This concept assumes that foreign demanders push for market-opening in order to promote potential exports, and suppliers offer market-opening to ensure that there will not be restrictions on exporting. Further, the concept holds that foreign governments and firms will pay the lobbying costs for market-opening. Foreign firms or their governments exert indirect pressure, or they apply pressure directly on the target government to open its markets to foreign trade. A firm's own government, whether or not it is pressured, may want export markets opened to the country's own goods, but must negotiate with the opposing governments for market-opening.

A further feature of the public choice framework is that the government is assumed to play the role of agent for lobbying groups (Baldwin, 1985; Olson, 1971). The concept of strategic trade policy (Grossman & Richardson, 1985; Krugman, 1986) suggests, however, that the government is likely to pursue market-opening even without being lobbied by pressure groups. In this scenario, the government seeking market-opening, with the support of international political forces, must threaten the opposing government with import restrictions (Jwa, 1988). It is assumed that the government that initiates market-opening perceives its costs, which include losing the general public's political support, as well as the support of protected groups, and also incurring the costs of adjustments in the import-competing sectors.

The public, including consumers, may have a nationalistic attitude toward merchandise and may be protectionist, a situation which can cause political difficulties. The public may then see market-opening in terms of capitulation to foreign pressure. This cost, which includes the costs of adjustment, most likely increases as the probability of market-opening increases. One must weigh the negative implications of market-opening against prospective improvements in allocation of resources and gains in the welfare of consumers (Jwa, 1988).

A review of the literature on profit-sharing points to the fact that a profit-sharing policy may be a trade policy option under a monopolistic market structure. Pressure for market-opening by the government can be regarded as a profit-sharing device that is similar to export subsidies. In this case, the demand force reflects the underlying reasoning behind the strategic trade policy. For supply forces, market-opening is the opposite of protection if there is control of foreign demand forces. Domestic pressure for market protection affects decisions about market-opening, and there is less likelihood of market-opening under these conditions.

Retailing and the Internationalization Process

The internationalization of marketing has been one of the fastest growing trends in business in recent decades (Sand, 1979; Wind, Douglas, & Perlmutter, 1973). Many products made in the United States are being consumed abroad. Furthermore, the U.S. market is now an appealing target for many foreign firms (Wang & Lamb, 1983). Salmon and Tordjman (1989) and Ford (1990) predicted future trends in retail expansion. Ford (1990) emphasized the changing economic role of the retailer and growing strength in retailing based on enhanced social mobility and consumer spending power.

Most of the theoretical issues related to retail internationalization have emerged in recent years as a result of the increased interest in the international activities of European and American retailers. Much of the existing literature relating to international retail activity focuses on expansion in strategic terms, based on longitudinal tracking studies, historical evidence, and some empirical studies.

Hollander's (1970) research suggests that, when retailing is transferred to international contexts, it may require substantial changes in format. These changes may include organizational changes, whereby management structures are developed that are appropriate for sustaining international growth. It may be necessary to shift authority to the operating units and away from a centralized control, allowing a more flexible and internationally responsive format. Hollander's early work (1970) concentrated on the effects of the political and economic environment on international expansion of marketing, giving as a reason for this expansion the weakening of domestic retailers' markets.

Foreign Direct Investment in Developing Countries

There has been a growing recognition of the need for the sustained flow of foreign direct investment, or FDI, to developing countries (Cable & Persaud, 1988; Page, 1987; Rothgeb, 1984). Several positive effects of FDI can be identified: FDI counteracts the need for private borrowing and the adverse effects of such borrowing; it provides capital and technology to developing countries; and it is a response to a changing international environment ("Foreign Private Investment," 1985; Jungnickel, 1993; Tolentino & UNCTC, 1990). As the attitudes of developing countries toward FDI change, policies toward FDI also change ("Foreign Private Investment," 1985, Cable & Persaud, 1988).

The increasing prevalence of FDI in developing countries has hastened the need to study the resultant changes. According to Amirahmadi and Wu (1994), "Many developing countries find it advantageous to rely more on FDI owing to its possible long-term beneficial impact on a country's development. The new attitude toward FDI has been more noticeable in developing countries. It is perhaps accurate to say that the aforementioned developments with respect to FDI are themselves the product of complex social, economic, and political changes that are taking place at both the national and international levels. The impacts of these changes in FDI flows remain scarcely analyzed in an integrative manner" (p. 166).

In the 1980s, FDI flows were not evenly distributed among developing countries (Jungnickel, 1993). Economic factors have been identified as the underlying causes of these uneven distributions. Sachs (1989), Savvides (1992), and Krugman (1986) have concentrated on analyses of demand-side factors, conditions in developing countries such as natural resources, the size of the domestic market, the rate of economic growth, foreign investment policies and incentives, and industrial capabilities. The demand side of the emergence of new markets for

FDI, occurring primarily in former socialist bloc countries, is of increasing importance for researchers. Amirahamdi and Wu (1994) indicated that the major reasons for the uneven geographic distribution may be found in shifts in FDI supply, varying economic conditions, and the varying investment environments found in developing countries.

Amirahamadi and Wu (1994) have suggested that sustained FDI flows to developing countries can be attributed to the following major causes: a shift in paradigms of thought about development, a domestic urgency for economic growth in developing countries, the globalization of production and services, and the changing international environment. These factors also situate FDI within a larger framework of ongoing, world-wide restructuring.

Amirahamdi and Wu (1994) developed a conceptual framework that suggests an explanation for the shortage of foreign exchange in many developing countries (see Figure 1). Their framework indicates that among the causes of this shortage are the combined effects of a general decline in the flow of private capital to developing countries, the uneven distribution of FDI flows, and chronic imbalances of trade. Some policy measures are available to developing countries that wish to attract more FDI. Among the measures are the fostering of a positive attitude toward FDI, liberalizing economic policies, seeking different forms of foreign investment, and concentrating on the development of human capital in addition to industrial capabilities. Amirahamdi and Wu (1994) asserted that "developing countries can also enhance the positive contributions of FDI through carefully screening technologies brought in by FDI, skillfully designing fiscal incentives, using zone policy at an appropriate stage of development, and establishing better support and diffusion systems for technology transfer" (p. 168).

Figure 1 Conceptual Framework for FDI in Developing Countries
(PDF, 5KB, Figure1.pdf).

One of the most important factors influencing the flow of FDI is the target country's economic condition. Indicators of economic condition include the rate of growth of the economy, and the economy's size in terms of per capita GNP. In some developing countries, FDI flows can be impeded by a number of major restrictions. In countries having large domestic markets and germinal industries, protective regulations may exist to encourage development of these industries by restricting FDI and thereby preventing foreign competition. The debt crisis experienced by a number of developing countries, due to heavy reliance on borrowing, is another important factor that affects the flow of FDI (Smith & Cuddington, 1985).

The fastest growing economies in the Northeast Asian and Southeast Asian regions have been China, Hong Kong, South Korea, Singapore, Taiwan, Indonesia, Malaysia, and Thailand. Economic growth in East Asia accelerated during the second half of the 1980s due in large measure to rising flows of investment into and among the East Asian economies (Young, 1995). These countries received over 90 % of FDI inflows to Asia in the 1980s (World Bank, 1993). "The most important component of an investment environment is the regulatory framework, or foreign investment regime. So, rather than open their borders to free trade, many developing country governments try to establish a free trade regime for exporting side by side with the protected trade regime for production for the domestic market say, by allowing unrestricted, tariff-free imports of raw materials and intermediate inputs for export production. Rather than allow free flows of capital, they selectively control inflows and outflows. And, rather than float their currencies, they adjust them regularly or from time to time. In addition to these adjustments, they can, for example, provide tax, financial, and other incentives to compensate exporters for the overvaluation of the exchange rate" (Rhee, Ross-Larson, & Pursell, 1984, p. 10). The degree of openness toward foreign investors varies among developing countries (Agarwal, Gubitz, & Nunnenkamp, 1991; "World Investment Directory," 1992). Currently, policies in the Asian NICs and Southeast Asian countries are generally more liberal than in other Asian countries.

As a nation develops, its population generally acquires more disposable income and increases its purchases of non-food consumer items. National patterns of product consumption are therefore likely to be related to the level of economic development (Douglas, 1971). Studies have established that ownership levels of consumer durables rise with increasing levels of development (Shipchandler, 1986). Thus, developing nations often provide consumer product exporters with attractive opportunities in growing markets. As the population of a developing country acquires more disposable income, its tastes in consumer items shifts and it becomes a market that is more available to foreign investment.

South Korea's Market-Opening Strategy

The literature reveals that South Korea's market-opening strategy is a result of many different factors. Policy has strongly been affected by the anti-opening pressures of domestic interest groups, as well as by U.S. pressure for market-opening. The government's concern for efficiency has played an equally important role. The probability of opening tends to be higher for products with higher protection rates, though the opposite tends to hold when U.S. pressure exists. Also, the policy of actively opening competitive sectors (industries) has been maintained (Jwa, 1988).

"It could be said that the behavior of the South Korean government has been not only self-interested, but also enlightened" (Jwa, 1988, p. 413). On the other hand, it is interesting to note that U.S. market-opening pressure may be the factor that inspires self-interest on the part of South Korea's protected industries and helps form a coalition of the South Korean government and protected industries. This factor could explain South Korea's shift away from a market-opening policy when it was pressured by the U.S. Seen in this light, the effects of pressure from the U.S. may be consistent with the theory that holds that market-opening is related to the effects of interest group politics. And further, pressure from the U.S. government appears to have inspired private firms in the U.S. to increase their lobbying efforts toward South Korea's market-opening. In this sense, market-opening can be seen to be influenced by the strategic trade policy of the U.S. government.

Problems with South Korean Retailing

A study published by the Organization for Economic Cooperation and Development (OECD) indicates that South Korean retail stores are redundant and understaffed, and that their sales are inefficient. The study investigated retailing in the 13 member nations of OECD. The report reveals that, in South Korea, there are 166 stores for every 10,000 people, which is a figure that is double the 79 stores to every ten 10,000 people in the U.S. Japan was shown to have a lower ratio than South Korea, having 132 stores per 10,000 people, followed by Denmark (100), France (97), Australia (90), Germany (85), Switzerland (83), England (81), and Canada (80). Only three countries -- Portugal with 192 stores, Greece with 184, and Italy with 101, rank higher than South Korea in number of stores per capita. The results of this study point to the inefficiency of South Korean retailing, in that more stores are needed to do the work that is done by fewer stores in more developed countries. The problem seems to lie in the fact that South Korea's retail stores are lacking in organization; that they are not sufficiently modern; and that they are not large enough in scale (Jang, 1997). One of the problems continuing to face South Korean retailing currently, as of 1997, is the low productivity of South Korean retailers.

The OECD study also reveals that South Korean stores have the smallest number of employees per store among the nations studied, indicating that service is likely to be slow, contributing to retailers' low productivity. South Korea has an average of 2 employees per store, compared to 6.6 in the U.S., 6.7 in Australia, 4.4 in Germany, 4.2 in Japan, and 3.9 in Denmark. Compared to the other nations studied, South Korean stores are understaffed and retail shop productivity is the least in South Korea (Jang, 1997).

Summary

A review of the literature reveals a need for theory that broadens the understanding of the process of internationalization and its effects on developing countries. Empirical studies, either cross-country studies or country-specific, time-series studies, will aid in theory development, as will country-specific descriptive/historical studies. Much of the literature on international retailing and market-opening consists of historical data, and to a lesser extent, of empirical studies, including those that involve longitudinal tracking. The primary areas that have received the attention of researchers are liberalization and trade regulations, market-opening and special interest-group politics, foreign direct investment in developing countries, and retailing and the internationalization process.

Due to the fact that South Korea's market-opening is a recent phenomenon, few studies have traced its effects. It can be seen, however, that there are problems with South Korean retailing, in that retailing has not yet achieved the levels of modernization, efficiency, and productivity that can be found in other open-market nations.

CHAPTER III

THE CONTEXT OF THE RESEARCH:
SOUTH KOREAN ECONOMIC HISTORY, 1948-1997

Introduction

South Korea’s market liberalization must be seen against a historical backdrop in order to understand those factors that influence the nation’s economy in general, and its retailing industry in particular. This chapter comprises a discussion of unique historical factors that provide a context for South Korea’s economic growth, as well as the economic difficulties and challenges that South Korea currently faces. The chapter is organized chronologically, according to the administrations of South Korea’s seven presidents during the time period of 1948 to 1997, and the chapter also includes discussions of the series of Five-Year Plans (FYP) for economic development (see Figure 2). The time periods of the Five-Year Plans do not correspond exactly to those of the seven administrations, and so for clarification, see Figure 3.

Figure 2 South Korea's Presidential Administrations and Five-Year Plans for Economic Development (PDF, 4KB, Figure2.pdf).

Figure 3 The Evolution of Market-Opening in South Korea (PDF, 5KB, Figure3.pdf).

Until its recent, rapid economic growth, South Korea had been a largely poor and undeveloped country, and in 1960 was poorer than most undeveloped African nations (Ian, 1989; Rodrick, 1995). South Korea has few natural resources, and three-fourths of its population were peasants living under conditions of poverty. South Korea has had a turbulent history, and has been long subjected to foreign interference. For centuries, the South Korean peninsula experienced invasions by more powerful neighboring countries, including Mongolia and China to the north and Japan to the East. South Korea was a Japanese colony for 35 years, and it endured the devastation brought about by World War II and the Korean War, which was a civil war that took the lives of three million South Koreans and divided the Korean peninsula into two nations. South Korea has been primarily an agrarian nation, and few industries of significance had developed by the years immediately following the Korean War ("The Economic Policy," 1995).

The nation's recovery was slow following World War II and the Korean War. South Korea had a narrow domestic market, negligible domestic savings, and a lack of experience in development. As unfavorable as South Korea's potential for development seemed to be, the country's economy has performed outstandingly in recent years. South Korea's rapid economic growth can be said to have begun in 1962 with the formulation of the First Five-Year Plan during the brief administration of President Yun Bo-Sun, a plan that continued during President Park's administration.

Five-Year Economic Development Plans

The First Five-Year Plan was South Korea's first attempt at systematic, formal, economic planning (Song, 1997). Six Five-Year planning cycles had been completed as of 1996. Since the initiation of the Five-Year Plans, South Korea has: (a) eliminated or revised its many trade regulations, as well as regulations affecting foreign investment and industry; (b) greatly reduced tariff rates to achieve a rate which is equivalent to the tariff rates of the world's most developed countries, which amounts to a trade-weighted rate of 6.2 %, as of 1996, on manufactured products; (c) abolished, as of 1997, registration requirements for trading businesses and restructured export-import approvals to create a negative list system; and (d) achieved a liberalization rate for foreign direct investment (FDI) into South Korea of 95.1 % of its business categories (the number of industrial sectors open to FDI), which amounts to 1,092 of 1,148 business categories listed in the South Korean Standard Industrial Classification. Under the negative list system, all items not included on the negative list may be imported without restriction (Frank, Kim, & Westphal, 1975; Hong, 1979).

The Five-Year Plans have had varying objectives depending on changing circumstances, including an increasing national income, changes in economic structure, and changes in economic priorities and concerns (Song, 1997). According to Samuelson and Nordhaus (1992), a government's proper economic functions are creating an appropriate economic legal framework, ensuring stability, and promoting efficiency, equity, and growth.

Much of the subsequent discussion is organized according to the administrations of South Korea's presidents, who are as follows:

Rhee Syng Man (1948-1960)
Yun Bo Sun (1960-1962)
Park Chun Hee (1963-1979)
Choi Kyu Hah (1979-1980)
Chun Doo Hwan (1980-1988)
Rho Tae Woo (1988-1993)
Kim Young Sam (1993-1998)

President Rhee Syng Man's Administration (1948-1960)

Rhee Syng Man was South Korea's president from the inception of the South Korean Republic in 1948 until he was ousted by a student uprising in 1960. He was faced with the task of repairing the South Korean economy and laying a foundation for the new republic.

Unfortunately, he had little regard for human rights, equity, or giving political power to citizens, and his government operated on the system of political spoils. During the period of Rhee's administration, South Korea was receiving massive amounts of aid from the United States, a situation which allowed South Korea to neglect long-range planning and development of the rural sector. The American aid program to South Korea began with a de facto set of short-run objectives. The South Korean relief program was initiated by the U.S. Military Government (1945-1948) under the assistance program known as the Government Appropriations for Relief in Occupied Areas (GARIOA). This program targeted three basic goals: a) prevention of starvation and disease; b) boosting of agricultural output; and c) massive provision of imported commodities to overcome the pervasive shortages of most types of consumer goods. The major priority was to raise agricultural production as rapidly as possible so as to make South Korea a net exporter of foodstuffs (Brown & Opie, 1953).

According to Steinberg (1988a, 1988b), Rhee took advantage of the U. S aid to South Korea by manipulating multiple rates of exchange simultaneously, enabling the Republic of Korea to gain the maximum resources from the U. S. and allowing some South Korean executives to become wealthy (Mason et al., 1980). Under Rhee's leadership, South Korea was able to establish the basis for successful outward-oriented economic growth by investing in education, introducing land reform, and completing the first stage of import substitution (Sakong, 1993).

The South Korean economy was greatly influenced by the United States during Rhee's administration, and decisions on economic policy primarily concerned ways in which to spend U. S. aid. U. S. aid to South Korea averaged about $270 million per year from 1953 through 1958, and the amount of aid determined the volume of South Korean imports (Cole & Lyman, 1971). In other words, foreign aid, primarily from the U. S., supplied sufficient foreign exchange resources for importing. The government increased the number of import-permissible items gradually from the first half of 1953 to the first half of 1959.

President Yun Bo Sun (1960-1962)

By the end of Rhee 's administration, the South Korean government was nearly bankrupt because of unfair tax collection policies and because of waste and mismanagement of foreign aid and domestic resources ("Revolution in April," 1995). A student-led revolution in 1960 forced President Rhee out of power, and on July 15, 1960, Yun Bo Sun was elected President of the Second Republic by a joint session of the new assembly. President Yun nominated Dr. Chang Myron as Prime Minister; however, the recently elected, democratic government was inexperienced and was not able to deal with the continuing civil disturbances. The student demonstrations, which were sometimes anarchical, were expressions of the social, political, and economic demands that had been suppressed under Rhee's regime. South Korea's experiment in democracy ended when the Chang government was overturned in a military coup led by General Park Chung Hee, on May 16, 1961. South Korea did not have a democratic government for the next 25 years (Steinberg, 1988a, 1988b).

President Park Chung Hee's Administration (1963-1979)

Despite flaws in his political career, President Park Chung Hee was a strong and effective president, and his leadership is regarded as a primary factor in South Korea's rapid economic development (Chung, 1991). When he assumed the presidency, President Park was faced with a nation that had serious economic problems. Most South Koreans lived in poverty, with a per capita income of less than U. S. $100. Park's philosophy can be found in his statement that "for such poor people like the Koreans on the verge of near starvation, economics takes precedence over politics in their daily lives and enforcing democracy is meaningless" (Park, 1963, p. 1). His attitude toward South Korea's trade and industrial policy in the early 1960s was typified by this often quoted phrase. This attitude assumed that the more and faster the economy grew, the better. The focus of South Korea was to be directed as much as possible away from politics and toward economic growth. *Suchul impguk* ("nation building through exports") was President

Park's favorite maxim. To President Park, setting highly ambitious export targets and then exceeding those targets was regarded as the height of achievement for businessmen and public officials in charge of export promotion (Song, 1990).

President Park favored maintaining a strict prohibition of foreign direct investment and a strict regulation of imports in order to avoid their competition with South Korean products. He was committed to economic development, which took the form of an outward-looking strategy, institutional reform, and active inducement of foreign capital for certain purposes (Sakong, 1993). Park did not view politicians favorably, and he suppressed political activities, although he encouraged discussions concerning economic affairs.

The expectation during President Park's administration was that South Korean businessmen should maximize exports instead of profits, profit being a secondary objective strategy. Discretionary government actions rather than "survival of the fittest" in the marketplace was the rule. "Fitness was judged in terms of the ability to expand exports, rather than based on profitability" (Song, 1997, p. 2).

The South Korean market remained relatively closed to foreign participation during the early 1960s and through the 1970s, a time period which was considered to be the beginning of the development phase of the South Korean economy. Foreign imports were restricted, and foreign investments were limited by strict regulations, with imports including only essential agricultural products or goods used in the production of exports. Foreign direct investment was limited to a few, select areas, primarily having to do with manufacturing and high-tech industries. Foreign participation in service industries was prohibited, except for banking and insurance, advertising, accounting, and legal services. Providing industries that were just beginning to develop with protection from foreign competition was a major objective of the South Korean government during the early 1960s and through the 1970s, and was accomplished through government intervention in the economy.

The First Five-Year economic development plan (1962-1966)

President Park's administration formulated, in 1962, the first of a series of Five-Year Plans for economic development. The years from 1962 through 1966 are considered to be the most important period in South Korean development. For years, while South Korea was under the Rhee administration, USAID (the U. S. Agency for International Development) had been attempting to initiate reform programs, an attempt which succeeded once President Park assumed leadership. USAID and the World Bank were instrumental in helping South Korea to formulate the strategies for import-export industrialization that began under Park's administration (Koo, 1996). "These policies included liberalizing the government's control of the market and taking steps to assist South Korea in achieving a fully realized, free-market economy. The policies were devised as basic strategies for economic development, and continued as guiding forces for the coming decades" (Cho, 1994, p. 2).

The First Five-Year Economic Development Plan can be seen as the transitional period in which South Korea's prior policy of reconstruction and domestic industrialization shifted to a policy that began to emphasize industrialization that was more oriented toward exports than toward the domestic market (Kim, 1975). Imports had been constrained since 1960 by problems with an account deficit and the necessity for promoting export industries and import-substitution industries to adjust the South Korean economy so as to lower its dependence on imports" (Luedde-Neurath, 1986, p.8). Trial and error in managing the balance of payments resulted in an increase in the degree of trade liberalization. The system of licensing imports was widened, allowing an increase in the list of automatically approved items. The number of permitted items rose from 1,948 in 1965 to 3,760 in 1967 (Luedde-Neurath, 1986). During the period of the First Five-Year Plan, imports of consumer goods were discouraged, while imports of capital goods, raw materials, and semi-finished goods for export and import-substitution industries were encouraged (Cho, 1994).

The Second Five-Year economic development plan (1967-71)

The Second Five-Year Plan continued the strategies devised for the First Five-Year Plan, due to the fact no significant changes had occurred in the domestic and international environments. The period of the Second Five-Year Plan was a time of rapid economic growth. Export growth averaged about 35.2 % annually in terms of dollars, which far exceeded reasonable expectations. During 1971, the last year of the Second Plan, export volumes actually doubled the anticipated amount. This growth was in part due to the stability of the government, in that President Park was re-elected easily in the 1967 presidential election and remained in power during the whole period of the Second Five-Year Plan (Cho, 1994). Park's phrase, "Nation-building through exports," appeared officially in the Second Five-Year Plan document, and it underlined the basic philosophy behind South Korea's trade and industrialization policies (Song, 1997, p. 2).

South Korea's increase in exports was paralleled by an even greater increase in imports, which had the effect of widening the trade deficit. This increase was due to a rise in the amount of intermediate, or partially finished, goods, which were then assembled by South Korean industries. Therefore, the rise in imports did not constitute a rise in final consumption goods, but in goods used in manufacturing (National Accounts, 1990).

Significant import liberalization does not seem to have taken place between 1965 and 1967. In mid-1967, during the first year of the Second Five-Year Economic Development Plan, the South Korean government adopted a major import liberalization policy, which was an important step toward general import liberalization. The government reformed the semi-annual trade program from a positive list system to a negative list system, which listed those items that could not be imported freely. The intention of this policy was to liberalize certain types of imports, but not to encourage a complete range of imports (Luedde-Neurath, 1986). The following objectives of this trade liberalization program were announced by the government: (a) to strengthen the international competitiveness of domestic industries and increase exports by opening up the domestic economy, which had so far been highly protected, to foreign competition; (b) to protect domestic consumers by increasing the degree of import liberalization; and (c) to contribute to the expansion of world trade volume as a member of the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT) (Kim, 1991, p. 47). The change in policy did not cause a significant increase in the volume of actual imports. According to the Korean Ministry of Trade and Industry, the value of the increase in imports attributable to import liberalization was only U. S. $22 million in 1967 (Luedde-Neurath, 1986).

South Korea shifted to a new system of import permits when it joined the GATT in 1967. Under this new system, all items could be imported automatically except for those that were import-limited or prohibited. The restrictions on limited or prohibited goods were announced in advance; all other goods were automatically unrestricted for importation. The purpose of this system was to gradually remove restricted import items from the list; however, this system did not accomplish much toward the import liberalization ratio (the number of goods that could be freely imported compared to the total number of goods) until the mid-1970s. The ratio of import-prohibited or limited-for-import items compared to items that could be freely imported was 58.5 % in 1967, and declined to 49.1 % by 1975 (Ministry of Trade and Industry, 1991).

Park promoted the chaebol (large conglomerates) by giving a chosen group of entrepreneurs easy access to government credit and capital, which limited opportunities for small entrepreneurs. This favoritism was in exchange for the chaebol's implementation of Park's policies. The dualism created by chaebol is a continuing factor in contemporary South Korea.

The Third Five-Year economic development plan (1972-1976)

The Third Five-Year Plan included policies of supporting heavy and chemical industries and promoting exports in the midst of rapid changes in domestic markets and in the foreign economic environment (Cho, 1994). By the late 1970s, exports and the GNP had experienced a dramatic rise, with slower gains in per capita income. This disparity was due to the fact that the chaebol benefited from Park's policies to a greater extent than did the South Korean people (MacManus, 1989).

The Fourth Five-Year economic development plan (1977-1981)

According to Koo (1986), the economic climate of the late 1970s was favorable to South Korea, in that the global economy was burgeoning, investments were forthcoming from capitalistic, core countries, and world markets were loaning money freely. Also, there was minimal competition from other labor-rich developing countries and there were relatively few barriers to trade. South Korea's export-driven expansion was increasingly dependent on its access to foreign markets, capital, and technology.

The primary trade-policy changes during the Fourth Five-Year Plan were the expansion of "policy imports" (imports related to exports), maintaining realistic and effective exchange rates, and expanding export subsidies, tax benefits, and foreign loans to exporting firms (Song, 1997). During the early years of the Fourth Five-Year Plan, there were huge investments in priority sectors; investments in exports and chemical industries were so heavy that the amount invested in these industries during the first three years of the plan period exceeded that planned for the entire period. In the 1970s, the dominant priority of South Korean economic policy was achieving export goals. The government and industry planners believed that the success of the economic plan depended upon the achievement of export goals, and thus exports were promoted by all means available. On the other hand, actual imports received less attention (Cho, 1994).

President Choi Kyu Hah's Administration (1979-1980)

President Park was assassinated on October 26, 1979. His successor under the constitution, Prime Minister Choi Kyu Hah, became acting president. His was a short-lived administration, lasting only nine months. This was a period of political, social, and economic unrest, which left the climate ripe for another military coup. President Choi was replaced by General Chun Doo Hwan on December 6, 1979 ("The Military Revolution," 1995).

President Chun Doo Hwan's Administration (1980-1988)

Chun Doo Hwan was similar to President Park in his authoritarian style and economic policies (Steinberg, 1988c). During his eight-year administration, governmental priorities determined access to credit to some businesses and not others, and the dominance of the chaebol remained the rule. Until the mid-1980s, the South Korean government essentially held a monopoly on institutional credit by controlling urban banks and rural cooperatives. The chaebol continued to have the ability to obtain credit, but capital was scarce for small and mid-sized businesses (MacManus, 1989). During the 1980s, protectionism increased, and core nations were disinclined to share new technologies with the increasingly more competitive South Korea.

The Fifth Five-Year economic development plan (1982-1986)

South Korea began to experience a surplus in its balance of payments, a situation which caused the U.S. and other trade partners to apply pressure to the nation to liberalize its trade policies (see Table 3) and to reconfigure its economic structure (Cho, 1994). The major changes in trade policy included intensive promotion of export goods and market diversification, reform of the export support systems, lowering tariff rates to expand importation of goods to be used in manufacturing, and expansion of loans associated with exportation of durable goods such as machinery and ships (Song, 1997).

Table 3 U.S. Pressure on Liberalization of the South Korean Market (1993 - 1997)
(PDF, 8KB, Table3.pdf).

President Rho Tae Woo's Administration (1988-1993)

Chun Doo Hwan’s presidency of South Korea came to an end in February, 1988, due to public demonstrations for democracy, more human rights, more equity in income distribution, and social justice (Cho, 1994). President Chun Doo Hwan's successor was President Rho Tae Woo. President Rho continued the process of South Korea's market-opening, in terms of trade and accessibility to foreign investment. As he indicated in his 1988 budget statement, he also was committed to capital market reform and to the resolution of trade difficulties with the nation's primary trading partners.

Under President Rho's administration, in the late 1980s, several South Korean import restrictions were relaxed and South Korean consumption increased, which contributed to the increased importance of marketing in the nation (Cook, 1989). South Korea began to approach a more mature stage of economic development, driven by the removal of some explicit import prohibitions and a steadily growing domestic demand ("South Korea Economic," 1994).

The Sixth Five-Year economic development plan (1987-1991)

With the 1985 Plaza Agreement, liberalization and market-opening were stepped up throughout the world economy. The Plaza Agreement was signed by the United States, the United Kingdom, France, West Germany, and Japan on September 22, 1985 at the Plaza Hotel in New York City. The significant goal of the Plaza Agreement was to coordinate the economic policies of these countries, known as the Group of Five, or G-5 ("The Plaza Agreement," 1995). At the time of the Plaza Agreement, South Korea was twelfth among all nations in trade volume, and could not afford to ignore the international trend for open markets. Responding to pressure from its trading partners, South Korea's Sixth Plan called for an increase in liberalization measures and in market-opening.

During the Sixth Five-Year Plan, the import liberalization ratio for manufactured items increased to 99.9 %, nearly matching that of advanced nations (Cho, 1994). The major contents of the policy reforms included the extreme reduction of various government regulations constraining growth of enterprises, plus extensive promotion of liberalization of finance, imports, and foreign exchange.

The Seventh Five-Year economic development plan (1992-1997)

The Seventh Five-Year Plan was initiated during President Rho's administration, and set as its main goal "pursuing an advanced economy and society and heading toward national reunification." (Cho, 1994, p. 56). The plan included the following three major strategies for satisfying the stated goal: strengthening the competitiveness of industry, enhancing equity and balanced development, and pursuing internationalization and liberalization. South Korea expanded service and agricultural market-opening, and strengthened the competitiveness of these sectors to continue the process of internationalization and liberalization of the country. To cope with the worldwide liberalization movement, including in the Uruguay Round of the GATT, and to promote the overseas investment of domestic firms, South Korea reorganized the areas of the economic system that did not meet international trade norms (Cho, 1994). The Seventh Five-Year Plan was suspended and replaced before the end of its second year by the New Economy Five-Year Plan (1993-1997) prepared by the Kim Young Sam government (Song, 1997).

President Kim Young Sam's Administration (1993-1998)

"President Kim's election in December, 1992, marked the end of decades of military rule that were characterized by civil war, the toppling of South Korea's first republic headed by Rhee Syng Man, the authoritarian rule of General Park Chung Hee, the succession to power of General Chun Doo Hwan, and the presidential election of Chun's classmate and former general Rho Tae Woo" (Ungson, Steers, & Park, 1997, p.2).

In February 1993, President Kim Young Sam's government took office, constituting the first civilian government since May, 1961. His government moved early in 1993 to shift South Korea's industrial policy from producer capitalism to market efficiency (Lee, 1995). The intent was to enhance South Korea's industrial competitiveness. President Kim Young Sam began quickly to stimulate and restructure the economy. The government made "Construction of a New Korea" its catch-phrase and in the short run geared policy toward revitalizing the national economy. Observers had expected that the new government would have much greater continuity with the outgoing Rho regime, but they were surprised at the speed with which the new government took action to implement the new policies (Cho, 1994).

The New Economy Five-Year plan (1993-1997)

In March, 1993, President Kim unveiled the 100 Day Plan to boost the economy. The main aims of the New Economy Five-Year Plan were to give greater freedom to the private sector and move away from the government control of development strategy that had prevailed for 30 years, and also to decentralize the decision-making process at every level of the economy: "the cornerstone of the economy lies in increasing productivity based on voluntary participation and private sector initiative.” ("The Beginning of," 1993, p. 3) The new government implemented its policy emphasis in order to stimulate growth (Cho, 1994). For the long term, the government directed policies toward restructuring the economy and launched the Five-Year Plan for a New Economy. There were few essential differences between this plan and the Seventh Five-Year Plan with respect to its goals and major policy issues (Cho, 1994).

The plan emphasized that the government would no longer lead or control management and the economy, as in the past, but that the economy would have its basis in the participation and innovative spirit of the South Korean people (Song, 1997). Industrial development would be helped by the government only indirectly, through government investments in technology, personnel, and infrastructure. Industrial adjustment was to be facilitated by eliminating entry barriers, simplifying socioeconomic regulation, simplifying administrative procedures, and inducing foreign competition (Lee, 1995).

“The goals of South Korea’s New Economy Five-Year Plan were to: (1) create a healthy economy characterized by economic vibrancy and national competitiveness, (2) achieve a "just" economy in which efforts to improve the competitiveness of all firms. . . large and small . . . are rewarded, and (3) develop a forward-looking economy that anticipates future global changes and prepares for future unification with North Korea” (Lee, 1995, p. 15). These goals were directed at eliminating regulatory barriers and facilitating foreign investment and trade. Since adopting the plan, South Korea has: (a) revised or abolished numerous regulations affecting trade, investment, and industrial operations; (b) reduced tariff rates dramatically for a current trade-weighted tariff average of 6.2 % on manufactured goods, the equivalent of tariff rates in the most developed nations; (c) reorganized export-import approvals to create a negative list system and abolished registration qualifications for trading businesses, both effective since 1997, and (d) liberalized 1,092 of 1,148 business categories, for a liberalization rate of 95.1 % ("KITA: Korea," 1996, p. 5).

The ultimate success of President Kim’s long-range economic plans is not certain. To encourage more inward foreign investment, regionally, in South Korea, in June, 1993 the South Korean government announced a Five-Year Foreign Investment Liberalization Plan for the period between July, 1993 and January, 1997 (Kim, 1994). The government's Five-Year Foreign Investment Plan, which was announced in early July, 1993, predicted a sustained annual real GNP growth of 7 %, raising per capita incomes from U. S. $6,800 in 1992 to U. S. $14,000 by 1998, and the promise of a "New Korea" of liberalized domestic and international policies. The plan called for the incremental liberalization of all 132 areas of business activity. This plan was adjusted and amended in June, 1994 (Chung, 1995). With the exception of public projects and those lines of business that are necessary for South Korea to carry out its basic economic policies, all businesses opened to outside investment. As a result, foreigners expected to be treated as equals with domestic firms in a free and fair competitive environment.

Summary

The evolution of South Korea’s economic development from a poor, undeveloped nation to the world’s twelfth largest economy has been remarkable and complex. The nation has moved from an autocratic government that supported the large business conglomerates, or chaebol, at the expense of the smaller businesses, to a democratic system and to policies that have lifted the former restrictions to foreign investment and the importation of foreign goods that now compete in the retail market with South Korean manufactured items. The nation is currently experiencing problems maintaining economic equilibrium in light of the rapid changes it has experienced.

Retailing in South Korea is part of a larger system that includes manufacturing, wholesaling, and competition with foreign investors and importers. In order to understand the place of retailing in contemporary South Korea and the factors that influence the retailing industry, it is necessary to trace the development of the nation from its post-Korean War reconstruction era to its current open-market status.

Beginning with the Rhee Syng Man administration at the inception of the new republic of South Korea, a series of Five-Year Plans was instituted to bring the nation into a competitive position with regard to industrialized, modern nations. South Korea has experienced an average economic growth of 8 % GNP per year for 30 years since it began taking steps toward economic development in 1962. Each of these Five-Year Plans can be seen as constituting an incremental step toward South Korea's taking its place as a nation with a globally competitive economy. However, currently, South Korea's economy is experiencing difficulties, including difficulties in the retailing sector, as the nation attempts to adjust to the changes brought about by its economic liberalization.

CHAPTER IV

RESEARCH METHODOLOGY AND PROCEDURE

Grounded Theory

In this study, the qualitative method of "grounded theory" was applied to explore and clarify the interrelated factors that have contributed to South Korea's present economic problems, especially those facing South Korea's retailing industry. This chapter describes grounded theory, and the steps undertaken in conducting the research including the methods of data collection and analysis. The chapter also discusses the limitations of the study. Grounded theory is a general methodology for developing theory that is grounded in data which are systematically gathered and analyzed. Theory evolves during the research, and it does so through a continuous interplay between analysis and data collection. As two of the major contributors to the field of qualitative research have commented, theory development starts with an extrapolation from "grounded events" (Glaser & Strauss, 1967). Theory building begins with understanding events or interactions, which then are investigated as to how they may fit into a larger pattern (Deshpande, 1983).

A central feature of this analytical approach is the "general method of constant comparative analysis," and therefore the approach is often referred to as the constant comparative method (Glaser & Strauss, 1967). This methodology may modify or elaborate upon existing theories, or theory may be generated from the data, as is. The methodology is flexible in that it may be modified or elaborated upon as additional data are gathered (Glaser & Strauss, 1967; Vaughan, 1992). This methodology differs from other qualitative research approaches in that it emphasizes the development of theory. Although grounded theory can be utilized at various levels, most grounded theory has been used to generate substantive theory (Glaser & Strauss, 1970). Grounded theory is a general methodology that can be adapted to investigations of various situations, because it is a way of conceptualizing data by discovering patterns and relationships (Wiener, 1981).

Although sociologists conducted much of the original research using grounded theory procedures, the procedures have been used in other fields and have varied depending on the specifics of the subject being investigated, the purpose and focus of the research, the adjustments needed as the research progressed, and the areas of expertise and interests of the researchers. For instance, Clarke (1990a, 1990b) and Star (1989) each utilized historical data in conjunction with fieldwork and interview data because their research purposes included gaining an understanding of historical origins and historical continuities in the scientific disciplines they studied.

According to Strauss and Corbin (1994), “One of the methodology’s central features is that its practitioners can respond to change over time. In other words, as conditions that affect behavior change, they can be handled analytically, whether the conditions are in the form of ideas, ideologies, technologies, or new uses of space. Grounded theory procedures force us to ask, for example, what is the power in this situation and under what specified conditions? Who manifests it, when, where, how, and with what consequences?” (p. 276).

The Market Liberalization of South Korea as a Case Study

In the context of this research, the market liberalization of South Korea and its effects on retailing are considered as a case study from 1948, which signified the inception of the new South Korean republic, to 1997, the year following full market liberalization in South Korea. The major advantage of using the case study is that the case study method typically relies on multiple sources, the findings of which may be converging. Yin (1989) pointed out six common sources of case study evidence: documentation, archival records, interviews, direct observations, participant-observations, and observations of physical artifacts. Yin (1989) also suggested three basic principles of data collection, all of which are relevant to the above mentioned sources of evidence. The three principles are: (a) the use of multiple resources of evidence and data triangulation, (b) the formation of a case study database, and (c) the establishment of a chain of evidence. These three principles are attendant to construct validity and reliability (Patton, 1990).

A study database is important to establish, as it contains raw data not necessarily included in the final case study report. The study database has to do with organizing and documenting original data from multiple sample units. In grounded theory, researchers often rely on triangulation, or the use of several kinds of methods or data (Denzin, 1978; Patton, 1989). In this study, triangulation of a variety of data sources was used to analyze (a) the historical and political context that set the stage for South Korea's market opening in January, 1996, and (b) the factors, or themes, that influenced the economic problems currently faced by South Korea and that have an impact on retailing in South Korea. Triangulation has to do with identifying repetitions among data collected from a variety of sources and then cross-checking the reliability and validity of the evidence for internal consistency. The identification of sequences of events produces a chain of evidence that can be analyzed. This chain of evidence implies themes that can be identified in the data, and it allows historical events to be placed within a larger topic or framework.

Data and Data Collection

Very few aspects of international marketing can be widely generalized to all nations or to all participants in global marketing. International marketing as a discipline is context-dependent and specific to the situation. None of the sources used in this study presented a complete picture of the effects of market-opening on South Korean retailers. Also, the economic situation in South Korea is still in a state of flux, and there is a lack of published material that specifically addresses the purpose of the present research. The current, scholarly work on the study topic is scarce; therefore, the work that has been examined in conducting this study is relevant to some of the larger issues that influence retailing in South Korea. This material primarily includes books and articles. The literature used as data sources has come from the fields of economics, marketing, and political science, and includes the topics of liberalization and trade regulations, market-opening and interest group politics, foreign direct investment in developing countries, and retailing and the internationalization process.

In addition to this literature, current accounts from articles in periodicals and newspapers and on the internet concerning the effects of market-opening on the South Korean economic situation and on South Korean retailing are utilized. This literature was reviewed in Chapter II. Although much of the data provided in that literature did not result from empirical studies, the derived information can be triangulated with data from other sources to determine patterns. Data from the above sources were grouped into initial themes, and as new data were discovered, they were related to these themes or used to generate new or additional themes.

Research Questions

Information gathered on the topic of the factors contributing to South Korea's economic problems, including problems facing the South Korean retailing industry, seemed to fall into certain broad categories. These categories include the effects of the following factors on the South Korean economy, and specifically, on South Korean retailing: 1) effects of perceived over-consumption of luxury items; 2) foreign direct investment; 3) South Korea's trade deficit; and 4) chaebol (see Figure 4 for a conceptual framework of the effects of South Korean market liberalization on the South Korean retail market). These categories generated the following research questions:

Figure 4 Conceptual Framework of Effects of South Korean Market Liberalization on the South Korean Retail Market (PDF, 5KB, Figure4.pdf).

(1) What have been the effects of perceived over-consumption of luxury items by South Korean consumers on the South Korean economy, including the retailing industry?

Over-consumption refers to the tendency of South Korean consumers to “over-spend” and to prefer imported luxury items to domestic products. The South Korean government has identified “over-consumption” as detrimental to the South Korean economy and its retailing industry, in that South Korean consumers have displayed changes in their preferences toward foreign imports, particularly from the United States. These preferences tend to be manifested in the selection of imported luxury items, thus putting South Korean-made luxury items at a competitive disadvantage.

(2) What have been the effects of foreign direct investment on the South Korean economy, including the South Korean retailing industry?

Foreign investment is defined, by the Foreign Capital Inducement Act (FCIA), as “acquisition of an ownership share of a domestic company in order to establish a continuous economic relationship with such company, including such purposes as participating in the management of the company (Lee, 1988, p. 56). Instead of enjoying an extended and gradual economic evolution, South Korea’s rapid modernization and entry into the international marketplace have been abrupt and have brought about economic extremes. These extremes have included South Korea’s poverty during the post-occupation period, the extravagant spending of more recent times, the trade liberalization, including the opening of South Korea’s markets to foreign direct investment, and the economic crisis that South Korea now faces. South Korea has been engaged in a struggle to maintain economic equilibrium as it confronts these rapid changes. The pre- and post-liberalization changes in policies, market characteristics, and foreign exporter characteristics are illustrated in Table 4.

Foreign direct investment (FDI) is a significant factor that impacts South Korea’s economy and its retailing industry. Figure 5 shows a conceptual framework for Foreign Direct

Table 4

Consumer Product Export Opportunities to Liberalizing South Korea: A Life-Cycle Approach

Stage	Policies	Market Characteristics	Foreign Exporter Opportunities
Pre-Liberalization	Encouragement of import substitution. Severe restrictions on consumer imports. Heavy taxation on consumption and/or upper incomes: discouragement of conspicuous consumption. High tariffs and quotas.	Sellers market. Restricted competition. Scarcity of products for consumer demand.	Very restricted.
Liberalization	Greater encouragement of free enterprise and competition. Encouragement of export orientation. Lower tariffs and quotas.	Greater availability of consumer products. Wider choice of products. Increased spending on consumer products. Reduced imports' costs compared with the pre-liberalized period. Possibility of curtailment or threats to continued access via foreign investment.	Substantially increased.

Note. Adapted from "Consumer product export opportunities to liberalizing LDCs, a life-cycle approach," by K. Gillespie, and D. Alden, 1989, Journal of International Business Studies, 20(1), p. 98.

Investment in South Korea (1988-1997), including its causes, trends, consequences, and policy implications. In the case of South Korea, FDI was limited by government policies until 1988. When foreign direct investment was expanded by market-opening, international products began to compete directly with South Korean manufactured and distributed items, and provided competition that South Korean products could not meet.

Figure 5 Conceptual Framework for Foreign Direct Investment in South Korea (1988-1997) (PDF, 7KB, Figure5.pdf).

(3) What have been the effects of South Korea's trade deficit on the South Korean economy, including the South Korean retailing industry?

In South Korea's current economic slow-down, the balance of trade has deteriorated, and South Korea's trade deficit with the United States and other advanced nations has been widening at an accelerating rate. The anticipated total foreign debt level in 1997 represented about 27% of the nation's GNP, which was a sharp rise from the 22.9% estimated in 1996. This unfavorable trend is unlikely to change any time soon (Lee, 1997). This deterioration is in part a result of market-opening, the accompanying competition with imported goods, and the decline in exports of some South Korean products.

(4) What have been the effects of "chaebol," or large conglomerates, on the South Korean economy, including the South Korean retailing industry?

Yoo and Lee (1987) defined a "chaebol" as "a business group consisting of large companies which are owned and managed by family members or relatives in many diversified business areas (p. 50). Retailers in South Korea are being increasingly challenged by competition from the chaebol, which now control 18% of the South Korean retail market. The smaller retailing companies find themselves at a competitive disadvantage with the chaebol, which historically have been protected and supported by the South Korean government. The South Korean government has relied heavily in the past on chaebol in its efforts toward economic development, and has supported the chaebol with tax benefits and policies. The rise of the big business groups was considered necessary to South Korea's rapid economic growth; however, the concentration of power with the chaebol is a cost of that growth, and their continued, dominating presence often has a detrimental effect on retailing by small-scale, South Korean businesses. Other problems with chaebol operations that have an effect on the South Korean economy and its retailing industry include the chaebol's heavy reliance on investing according to personal and family relationships, often at the expense of efficiency and open competition.

Data Analysis

There is no uniform technique for analyzing qualitative data, and there are no clear definitions of methods for their analysis (Miles & Huberman, 1984; Yin, 1989). The qualitative researcher takes the responsibility for being thorough and for applying his or her integrity and experience to the task. Evidence must be well presented, and alternative implications of the data and findings must be considered.

When analyzing the functioning of a system, such as that of the economy and the retailing industry of South Korea, the review of documents and records can clarify the behavior of that system. Additional data can modify suppositions, or they can present new topics and processes that must be incorporated into the analysis and can lead to modifications. One disadvantage of archival data is that it often contains a lot of information not directly related to the topic of interest. Despite this shortcoming, Webb and Weick (1979) advocate the use of archival data because such data can be effective in research on complex systems. Archival data can be used to provide triangulation with other types of data and can document historical events and show change over time (Paul, 1996). The use of archival data found in the literature can provide information about events of the past and present, can speculate about the future, and can substitute for the researcher's travel to specific locations to interview respondents when those types of activities are not feasible.

The purpose of asking questions and gathering evidence is to gain an understanding of the subject under consideration. Theories or hypotheses used in qualitative research cannot be proven absolutely, but can aid in understanding a complex system (Brown, 1962).

Limitations of the Research

Because the data in this research were derived from examining literature from various sources, they may lack the detail that could be provided by surveys and statistical analyses. A limitation of the study is that, because the factors that impact the contemporary economic conditions in South Korea are closely interrelated and influence one another, it is not possible to establish a clear causality in terms of their effects on South Korean retailing. Another limitation of the research stems from the fact that South Korea's economic situation is changing rapidly, and new factors may arise that impact the South Korean market.

Summary

Several interrelated factors have contributed to South Korea's current economic problems and to the problems faced by South Korea's retailing industry. These include foreign direct investment in South Korea, the price-gap between domestic and imported luxury goods, "over-consumption" by South Korean consumers, the effects of the chaebol on the South Korean economy, and the trade deficit between South Korea and the U.S. and other advanced nations.

As South Korean markets become increasingly open to foreign trade, the role of foreign direct investment exerts an increasingly competitive influence on the economy. Although foreign direct investment can be expected to add vitality to the economy, it may also cause market instability that affects most areas of the economy, including retailing. Retailing in South Korea is rapidly expanding and changing, and the smaller retailing companies are increasingly being challenged by the large business conglomerates, which historically have been protected and supported by the South Korean government. Another factor that impacts the economy in general and retailing specifically is the price-gap between domestic and imported goods, a situation that has the potential of damaging South Korean industries, including textiles, manufacturing, and retailing. The rapid growth of the South Korean economy, combined with the demonstrated preference of the South Korean consumer for imported goods led to a trend of what the South Korean government has termed "over-consumption," where consumers spend extravagantly on foreign, luxury imports. Another effect of South Korea's market-opening is the disequilibrium of the economy, which has been accompanied by an acceleration in the rate of the South Korean trade deficit with the U.S. and other countries.

CHAPTER V

CHARACTERISTICS OF RETAILING IN SOUTH KOREA

Introduction

In order to discuss the effects of market-opening on the South Korean economy, including its retailing industry, it is necessary to place this information into context by explaining the characteristics of South Korean retailing. Retailing is very different in Asia than it is in the United States. The emphasis in Asia is not on the merchandise mix, positioning, format, and vendor management, as it is in the U.S. South Korea's manufacturing-driven retail stores bear no distinct identity apart from being dealers in specific brands. South Korea has a complex network of small independent wholesalers that rivals Japan's network. Japan's distribution structure influenced South Korea during the Japanese occupation of Korea from 1910 to 1945, although the relationship between the two countries remains strained (Quinn, 1992).

Although the GDP level in South Korea is higher than in many Asian countries, the retail sector is largely undeveloped. The retail sector in South Korea consists of a complex web of many very small independent operators and a handful of large department stores (Zhang, 1995). In other words, retailing involves a large mix of retail businesses: small privately owned specialty outlets, a small number of franchises, manufacturer-owned outlets, as well as a number of door-to-door sales companies. The distribution sector is still dominated on one side by the thousands of tiny neighborhood stores that offer a narrow range of basic goods, and on the other by about 30 large domestic department stores run by corporate groups such as Lotte, Shinsegae, and Midopa in the major cities ("Distribution/Foreign Brand," 1993, "Profile: South Korea," 1994). In other words, South Korean distribution markets are largely split into two types: department stores and conventional retail markets. A wide variety of store types can be found, including wholesale markets, open air markets, department stores, supermarkets, general merchandise stores, chain stores, underground shopping arcades, discount stores, and convenience stores (Park, 1995).

Wholesalers tend to dominate the distribution system, but the distinction among wholesaler, distributor, and retailer is unclear (Quinn, 1992). Retailing in South Korea is still overwhelmingly run by small, privately owned family shops. The approximately 710,000 officially registered retail outlets in South Korea (1990 estimate) represent little more than a token of the total; to these should be added the small street outlets and market stalls around the country, which run into hundreds of thousands. Total employment in the retailing sector is officially estimated at 1,260,000, but this is obviously too small -- less than two per outlet, in fact. It is estimated that about 91% of South Korea's retail shops have less than two employees, with an average sales floor space of 10 square meters or less. Their annual average sales total just US$ 40,000 per store. With such low annual average sales, it is difficult if not impossible for local retailers to acquire even low-priced real-estate and expand their operations. South Korea continues to have a very large and growing number of small independent retailers, but major development in large-scale retailing had its beginnings in the 1980s. The number of department stores, supermarkets and other general merchandise stores has grown by 140% since 1982 ("South Korea," 1995).

The local retail and manufacturing companies are destined to undergo drastic changes in the face of an excess of high-quality, low-priced foreign imports. The industry's international competitiveness is extremely weak because of outdated management techniques. The substantial improvement in the level of living in South Korea has resulted in growth in demand for quality, diversity and aesthetic values in retail goods ("Distribution Industry Need," 1996).

Although department stores are gaining a greater share of retail sales, the level of retail sales has been rising in all sectors of the retail industry, with small family outlets still retaining a dominant position. In 1991 there were some 11,388 general merchandise stores and 90 department stores in South Korea, up 15% over 1987; retail sales by department stores increased some 246% between 1987 and 1991, against only 116% for all retail sales (see Table 5).

Expansion of the South Korean Retail Industry

The South Korean retail industry has been expanding rapidly since the 1980s when the nation's economy was still in recession in the wake of the oil shock. Despite the slow-down in economic growth in the 1990s, sales in the retail distribution industry have surged as a result of new investment and the introduction of modern management skills by the big companies. Moreover, the advent of new specialty department and discount stores has further accelerated the retail industry's development, as have the expansion of business districts, the spread of credit cards, and the active participation in retailing of the big companies (Lee, 1996b).

Distribution Industry

The distribution industry, which is the physical-handling process that involves moving the merchandise from the receiving, checking, and marking area to the sales floor, the stockroom, and/or other units of a multi-store group (Mason, Mayer, & Ezell, 1980, p. 551), plays an important part in the South Korean economy, as shown by the facts that it accounted for 14% of the GNP, and its employees were 23.4% of the economically active population, as of 1993. But the structural weakness of low productivity in all South Korean industries is becoming a major factor in raising distribution costs and commodity prices. According to the

Table 5

South Korea: Retail Sales by Major Outlet Types, 1987-1991

Major Outlet Types	**1987 (Won billion)**	**1991 (Won billion)**	**% Change**
Department Stores	1,090	3,771	246
Supermarkets	1,038	1,792	73
Others	22,078	46,615	111
Total	**24,206**	**52,178**	**116**

Note: Adapted from "South Korea". by Euromonitor, 1995, Retail Trade International 1995, 1, p. 1041

Federation of Korean Industries officials, South Korea's distribution industry has grown to account for 11.7% of the country's gross domestic product and 26.2% of the total employment (Park, 1995).

At present, the distribution of consumer goods is dominated by licensed dealerships. Lotte, in partnership with Japan's Takashimaya, controls the most prestigious shopping location in South Korea and offers the biggest selection of imported goods. Shinsegae, owned by manufacturing conglomerate Samsung, is another major force. In 1993, Shinsegae opened E-Mart, South Korea's first discount "superstore." And, in 1995, a Price/Costco/Shinsegae joint venture opened South Korea's first warehouse club (Zhang, 1995). Toys 'R' Us and Pinault-Printemps also have significant influence on South Korean retailing, both focused on a middle market. The growth of the high end of the market has been stunted by government policies to discourage consumption of luxury goods (Zhang, 1995).

National Coverage

The South Korean consumer market for most products is concentrated in major cities. The primary center for retailing activity is in the urban areas where the urban population density is one of the highest in the world. Seoul, where the majority of the urban population resides, contains 24% of all retail outlets, handling 38% of all retail sales. Some 25% of all South Koreans live in Seoul. Other major cities, mainly located on the coast, are Pusan with some 9.6 million people, Taegu with 2 million, Inchon with 1.3 million, and Kwangju, Taejon, and Ulsan with a combined population of around 1 million people, also represent major retail centers. The rural community accounts for only about 30% of the total population, and therefore rural areas have a much smaller percentage of retail activity (see Table 6). Most large South Korean firms maintain home offices in Seoul, the nation's capital and leading industrial center. A growing number of firms have head offices in other main industrial cities, including Pusan, Taegu,

Table 6

South Korea: Number of Outlets by Main Location and Shop Density 1990-1991

Main Location	Number of Outlets 1990	Number of Outlets 1991
Seoul	**184,851**	**172,541**
Pusan	**64,828**	**69,594**
Taegu	**38,999**	**39,453**
Inchon	**25,439**	**29,971**
Kwangju	**18,749**	**20,335**
Other areas	**377,022**	**384,896**
Total	709,888	716,790
Outlets per '000 population	*16.5*	*16.7*

Note: Includes motor, fuel and accessories outlets. Source: South Korea: Number of Outlets by Main Location and Shop Density 1991, by National statistics, 1991. South Korea: Number of Outlets by Main Location and Shop Density 1990, by National Statistics, 1990

Inchon, Suwon, Changwon, Masan, Yochon, Ulsan, Pohang, and Kwangyang (Steer, Shin, & Ungson, 1989).

Retail Trade by Outlet

Discount Stores

Having moved into the first rank of industrial nations, South Korea is now developing a retailing structure and consumer market to match. More and more housewives living on the outskirts of Seoul are choosing to shop at discount stores, which are proliferating rapidly in Ilsan and in other cities on the outer edges of Seoul, such as Bundang and Chungdong in Puchon. The first three discount stores in South Korea opened their first outlets in Seoul, rather than in the outer Seoul region. Shinsegae, the well-known department store giant, began the trend in 1993, with the well advertised opening of E- Mart's first branch. Price Club, a joint venture between Shinsegae and the American Price Club discount store, opened its first branch in Seoul, in 1994. In 1995, New Core, another big name in department stores, opened Kim's Club in Seoul (“Ten Large Retail,” 1996).

Seoul proved to be too small, however, for the huge discount stores, which had difficulty making ends meet, with high maintenance costs and with overwhelming competition from other, better established retail forms such as supermarkets and department stores. Therefore, the discount stores turned toward the satellite cities (Koo, 1996). About ten large sales facilities, especially discount outlets, opened in 1996 in Bundag, Ilsan, and other newly developing cities near Seoul, resulting in strong competition among major retailers to explore underdeveloped commerce ("Ten Large Retail," 1996). There were several advantages to establishing stores in satellite cities. Land prices were comparatively cheaper than in Seoul, thus lowering maintenance costs. The dense population of newly established residents living in row upon row of apartment blocks signified consumer potential. Plus, small and medium sized stores had not taken control of the shopping network in those areas. Social and economic factors also were on the side of discount stores. The recent slow-down of economic growth meant that people were spending less on luxury items, while concentrating on buying necessities cheaply. Satellite cities were also desperate for their own giant stores -- most of their dwellers were tired of going into Seoul every time they had to make a major purchase. E-Mart first opened in Ilsan in 1994, signaling the trend to establish discount stores outside of Seoul. Others were slow to follow. With the opening of the local distribution sector to international competition (Koo, 1996), 27 new outlets accelerated their store construction process beginning in 1996 ("Distribution Ind. Prepares," 1996).

The super-center is a new type of discount store, in that it is a discount store meshed with a supermarket. By adding a supermarket's groceries to their product offerings, the super-center guarantees one-stop shopping and a complete product line. With these merits, it is expected to compete well with the increasing number of warehouse discounters in South Korea. Samsung has established a liaison with Wal-Mart, the developer and successful operator of super-centers in the U.S. ("Super-Center Discount," 1995).

Discount stores are the latest boom in South Korea. In 1994, E-Land, South Korea's largest apparel firm, opened its first discount outlet with savings of 50% on clothing and big bargains on household goods. By the year 2000, E-Land plans to open more than 100 "next generation" department stores in the housing developments that have sprung up around South Korea's major cities (Eisenstodt, 1995). Newcore Department Store and Shinsegae Department Store are competitively setting up branches of their membership-only discount stores. Midopa Department Store turned its Chongryangni store into a discount store. Kim's Club, a discount house that was opened in June 1995 by the South Korean department store operator New Core, appeals to nationalistic sentiments by emphasizing that it mostly sells made-in-South Korea goods. Wal-Mart boosted the domestic industry in the U.S. with its buy-American policies. Kim's Club intends to do the same thing for South Korea (Eisenstodt, 1995).

The so-called "lowest price guarantee" system was introduced competitively among discount stores at the height of their intensifying off-price competition. E-Mart discount store in Bundang, a booming bedroom town near Seoul where almost all major discount stores have entered or plan to enter soon, began in early May 1997 with unprecedented services to provide customers with goods at the lowest possible prices. Under their service policy, if people buy goods in the store and find that other stores in the vicinity sell the same products at cheaper prices, the price differences would then be refunded. The consumers just need to present receipts or the other stores' materials carrying price tags, within three days from the purchase, for compensation, an E-Mart official said. The store's move is drawing keen attention, since it is the first attempt for the "Every Day, Low Price" discounters (“Discount Stores Struggle,” 1997).

The "cheapest price compensation" system is a sales tactic generally employed by supermarkets and other small retailers for a limited number of items to attract more consumers. In the 1970s Wal-Mart Stores, the leading U.S. discount chain, successfully used the system for its sales growth. Additionally, through price surveys on other retailers' trends, the E-Mart in Bundang plans to frequently adjust its prices to maintain the lowest levels and to ultimately win in the highly competitive price battle. Kim's Club, the largest discount store chain, attempted to implement the system to provide the cheapest prices, but gave up due to practical problems. Recently, it reduced prices for 150 items in its stores as a prerequisite to introducing the "lowest price compensation" system. A multinational discount chain, Carefour, will follow E-Mart in the lowest-price race. A Carefour official said that the movement is already in place in some of its European and Asian stores (“Discount Stores Struggle,” 1997).

Shopping centers and arcades are also a major feature of retailing in South Korea. They have emerged in a variety of ways over the past 19 years; in some cases traditional market stalls have been upgraded into permanent retail outlets. In others a major trading company or hotel has initiated the development of a center and remained the overall manager ("Republic of Korea," 1989).

Department Stores

Department stores in South Korea can be taken to include stores which in other countries would be classified as variety stores. They include all large stores selling a variety of goods, but not primarily food, on a non-self-service basis. Department stores vary considerably in sophistication and product range. The major Seoul department stores offer a wide range of domestic and imported goods, and they have also begun to offer a variety of customer services ("Republic of Korea," 1989). Until recently, the general conception was that department stores were only for the rich and the privileged, due to the luxurious and sophisticated atmosphere in the department stores with highly expensive goods, making less fortunate people feel uncomfortable and rich people feel more lavish with their money. With the changing times, however, the industry has had to adjust to satisfy the needs of consumers in order to develop. Department stores are no longer restricted only to a small percentage of people with money, but have become popular and commonplace for anyone to shop ("Department Stores Broaden," 1993).

By 1987, 97% of all the 42 department stores in operation in South Korea were located in Seoul, and the remainder were in the country's other major cities. In 1990, 63 department stores were in operation in South Korea, 40 of them in Seoul, and the remainder in the country's other major cities. Eleven new department stores opened in 1995 ("Distribution Ind. Prepares," 1996) (see Table 7).

South Korean department stores are raising the ratio of direct purchase and sales of goods to total sales in an effort to evolve their operations from a system of consignment sales to direct purchase and sales. Under the system of direct purchase and sales, which is being widely used in many advanced countries, department stores reportedly can earn higher distribution margins by assuming the burden of warehousing goods ("Department Stores Cutting," 1991). South Korean department store operators typically do little more than rent out space to merchants in exchange for around 30% of revenue (Weinberg, 1996). Tenants supply their own salespeople, racks and

Table 7

South Korea: Number of Department Stores September, 1979-1994

(Number of Stores)

Area	**Until 1979**	**1980 - 1984**	**1985 - 1989**	**1990 – September 1994.**	**Total**
Seoul	5	6	17	10	38
Metropolitan Areas	-	2	5	12	19
Other Regions	4	11	11	11	37
Total	9	19	33	33	94

Note: Metropolitan Areas include Kyungki-Do and Inchon. Adapted from Fashion Distribution Industry, by H. J. Lee, 1996, p. 38.

displays. The result is tightly packed, cluttered stores similar to flea markets with roofs ("Republic of Korea," 1992).

The recent sales performance of South Korea's department stores suggests that consumers prefer shopping at department stores more than at other stores (“Annual Report On,” 1997). This is a significant change from the 1960s. Changes in the quality of service, management, and business strategies of department stores probably have accompanied or followed the rise of consumers' appreciation. The efficient and scientific approaches of department stores have contributed much to the development of South Korea's shopping culture.

New Types of Retailers in South Korea

Category Killers

The "category killers," or specialty discount stores, are gradually gaining popularity in South Korea due to the noticeable price advantages and deep merchandise offerings. Despite the generally flat retail business, specialty stores such as Sports Depot and Toy Land are performing fairly well, and they are becoming important cash cows for the parent retailers. New Core department store operates 30 small and medium-sized category killing outlets of Sports Mart, Toy World, Office World, Electronic World and some other brands (“Specialty Discount Stores,” 1997).

Specialty Stores

The specialty stores, mostly located in department stores and Kim's Club discount stores, earned US$ 13,300 a month in 1997, thus contributing greatly to the sales goals of retailers. New Core department store remodeled its Seohyun-dong branch in Bundang to create a store filled with specialty discount stores, and it plans to do so for some of the poorly managed New Core department stores (“Specialty Discount Stores,” 1997).

Convenience Stores

South Korean traditional small retail shops are different from convenience stores found in other countries and are gaining popularity in South Korea. They are called “Kumongagae”, or “mom-and-pop” stores, and are run by small independent Korean operators. South Korean consumers are increasingly turning to service-oriented convenience stores at the expense of small, open-fronted shops and small shops run by independent operators. The approximately 400 convenience stores located in Seoul have put pressure on Seoul’s estimated 100,000 kumongagae and its several thousand medium-sized supermarkets (Paisley, 1992). In the process, the service-oriented convenience stores are revolutionizing the retail business.

Since convenience stores first made inroads into South Korea in 1989, they have been opening new outlets at an astounding rate. There were 709 convenience stores around the country in 1993, with the majority being concentrated in Seoul ("Where Their Doors," 1993). As of the end of April 1997, the number of convenience stores broke the 2,000-outlet mark in the eight years since their introduction in South Korea (see Table 8) ("Convenience Stores Surpass," 1997).

The sudden increase of convenience stores occurred after the South Korean government allowed the limited market-opening in 1989. South Korea allowed joint venture convenience stores to begin operations because of pressure from major trading partners—the EC, North America, and Japan. In 1991, the South Korean government gave limited rights to open a maximum of 10 directly owned stores apiece to foreign chains (Paisley, 1992).

Convenience stores in South Korea sell about 2,000 or so different items, which is far

Table 8

Yearly Increases in Numbers of Convenience Stores

Year	Number of Stores	Year Total Growth
1989	7	--
1990	39	32
1991	277	238
1992	688	411
1993	1,296	608
1994	1,439	143
1995	1,620	181
1996	1,881	261
Jan - April, 1997	2,030	149

Note. Adapted from "Convenience Stores Surpass 2,000 Outlets in 8 yrs. from Introduction.", 1997, June. The Korea Economic Weekly, p. N/A.

below the average of 4,000 items per store in the U.S. Now that foreign retailers are allowed to operate in South Korea on an essentially unrestricted basis, with their popular brands and extensive product lines, not to mention their marketing expertise, they are almost certain to supplant the traditional mom-and-pop stores in only a matter of time. Furthermore, the locally owned convenience stores will be forced to upgrade their inventory as well as their quality of service in order to compete with the giant foreign convenience stores, such as Circle K, Family Mart, Lawsons, Mini Stop, and 7-Eleven. There are currently eight major chain stores in South Korea: Buy the Way, LG25, Mini Stop, 7-Eleven, Circle K, AM-PM. Family Mart, and Lawsons. Except for Buy the Way and LG25, all of them are imports tied to foreign companies, with Family Mart and Mini Stop linked with Japanese firms, while the others have U.S. connections ("Wholesale changes," 1996) (see Table 9). So far, none of the foreign partners has opted to open any directly owned stores. South Korean convenience-store companies believe that they have a competitive edge against the joint ventures because all the joint-venture companies pay foreign partners a 1% royalty on their revenue (Paisley, 1992).

Convenience-store chains in South Korea are mostly interested in competing with Kumongagae and supermarkets, which also need the consumer-service skills and clean facilities that South Koreans are increasingly demanding. Convenience-store chains welcomed greater liberalization of the retail industry so that foreign products could be priced competitively against blackmarket items, but this was inadequate because high tariffs on the most popular foreign items available in the blackmarket have remained in place. Even though Kumongagae, which sell some blackmarket items, and supermarkets have a competitive advantage due to cheaper prices than convenience stores, they are losing the fight for customers, especially among younger South Koreans who welcome clean stores and service with a smile. More than 60% of the customers of convenience stores are in their 20s and 30s, and by contrast, Kumongagae and supermarkets depend on older customers for business. The competition from convenience stores has caused a lot of damage to Kumongagae (Paisley, 1992).

Table 9

10 Major Chains' Convenience Stores

Chains	Date of Establishment	Joint Country/Company
Family Mart	'83. 10. 6	Japan / Family Mart
LG 25	'71. 2. 13	Korea
Lawsons'	'89. 2. 24	U.S.A. / Daily Mart
Mini Stop	'74. 4. 2	Japan / Mini Stop
Circle K	'89. 5. 10	U.S.A./ Circle K
JR Bestore	'94. 9. 7	Korea
7-Eleven	'88. 5. 21	U.S.A. / South Land
Buy the Way	'90. 6. 30	Korea
AM-PM	'91. 3. 15	U.S.A. / Am/Pm
Spar Metro	'93. 6. 11	Korea

Note. "10 Major Chains' Convenience Stores," by Ministry of Finance and Economy, 1997, 1997 Distribution Statistics, p. 158.

Non-store Retailing

Home Shopping

The early success in South Korea of home-shopping broadcasts is somewhat surprising, because South Korea is a country where retailers do not favor even rudimentary direct marketing methods such as catalog sales. Furthermore, the South Korean consumer has always enthusiastically engaged in the buying and selling of goods as a social ritual intrinsic to the culture of South Korean society. Home shopping is a truly innovative marketing technique in South Korea ("Home Shopping Wows," 1995).

Although the major customers of TV home shopping are housewives, home shopping is a growing favorite among double-income families with little time to shop after working hours. Although telemarketing cannot provide consumers with enough information, home shopping through cable TV can give consumers information about goods and their usages. In South Korea, ‘39 Shopping’ and ‘Hi-Shopping’ began home shopping broadcasts in August 1995. Although South Korea's cable broadcasting network is not fully developed, at least 20,000 consumers have purchased goods through cable TV home shopping since its first broadcast. TV home shopping companies are offering goods with prices 20-50% lower than in regular stores. In addition, they provide small- and medium-sized manufacturers, which have difficulty persuading large outlets to stock their products, with the opportunity to approach shoppers (Shon, 1997).

Multilevel Marketing

Multilevel marketing is a distinct type of door-to-door marketing, in that the consumers themselves are at the same time sellers. By sidestepping intermediary sellers, such as wholesalers and retailers, and by saving money from advertising and logistics, the marketing method can cut distribution costs sharply. Foreign multilevel marketers are continuously expanding their presence in the emerging South Korean market. As of December 1996, the number of registered multilevel marketing companies totaled 106, including 13 foreign firms.

While foreign firms represent 14% of the South Korean multilevel marketing businesses, their sales between July, 1995 and June, 1996 amounted to 325 billion won, accounting for 74% of the total. The current market leader is Amway Korea, the world's largest multilevel marketing firm headquartered in the U.S. Amway's sales of 246.7 billion won constituted more than half of the multilevel marketing industry's total in South Korea in the first business year after the government completely legalized it (Shon, 1997). Amway Korea Ltd. is dominating the nation's multilevel marketing sector that was opened to foreign companies in July 1995. Following Amway is Nuskin Korea, from New Zealand, which specializes in cosmetics and bathing goods ("Amway Dominates Domestic," 1997).

The share of foreign multilevel marketing companies like Amway Korea and Nuskin Korea has surpassed 70% of the South Korean multilevel marketing activity, thus giving serious competition to domestic firms ("Foreign Multi-layer Marketing, 1996). In 1996, there were 96 registered multilevel marketing companies, of which 13 were from overseas ("Foreign Multi-layer Marketing," 1996).

South Korean multilevel marketing firms were having a difficult time gaining market share in the local multilevel sales markets, at least as of 1996; however, following the entrances of the nation's leading companies into the business, South Korean multilevel marketers are competing aggressively with high-quality daily commodities (Shon, 1997). Industry analysts have said that, armed with accumulated marketing know-how, well-educated consumer compensation services, and diverse and quality product offerings, the foreign companies have easily swept the South Korean market. On the other hand, domestic participants are mostly small, and they maintain out-of-date "pyramid" marketing traits ("Multilevel Marketers From," 1996).

Cyber market

A new type of shopping and information service debuted in South Korea in June 1997 ("Hansol To Launch," 1997). Giant South Korean retailers and distributors are venturing onto the internet to expand the scope of their activities in cyberspace ("Internet Shopping Explores," 1997). Hansol CSN (Cyber Service Network), a subsidiary of the Hansol Business Group, launched CS Club (Cyber Shopping Club), a sophisticated membership-based shopping service using various telecommunications media. Hansol's CS Club is aimed at enabling members to purchase a wide array of goods and services at low prices through the internet, PC online services, telemarketing, and direct mail. As such, CS Club set up a store on the internet instead of on the streets. Members can order goods and services at home and have them delivered to their homes ("Hansol To Launch," 1997).

South Korea's two big department store giants, Lotte and Shinsegae, are staging a new level of competition on the cyber market. The Shinsegae electronic market is being operated on a small-profit and many-sales basis through sales of products from its discount stores E-mart and Price Club. To defend its top place in cyber shopping, Lotte is also strengthening its sales strategies ("Hansol To Launch," 1997). Lotte opened its home page, Cyber Shopping Mall, the first of its kind in South Korea in May of 1996 ("Internet Shopping Explores," 1997). Lotte introduced an "internet auction" for the first time in the nation in June 1997, and it is providing various benefits to customers, including free-of-charge delivery. As of the end of May 1997, Lotte was securing 45,000 internet clients with average monthly sales of 150 million won. Competition among domestic department stores on the net became even more fierce when Hyundai Department Store jointly opened its cyber shopping, dubbed "metaland," with 17 other companies, in September 1997 ("Lotte, Shinsegae Stage," 1997).

Telemarketing

Among the recent nonstore distribution businesses, the growth in the telemarketing business is remarkable. Since the domestic market liberalization, foreign telemarketers have been entering South Korea one after another, which has resulted in a rapid expansion in the volume of the market. The number of current telemarketing companies working in the South Korean distribution market amounts to 500. The local telemarketing business has been growing sharply by an average of 40 to 50% a year since 1990 (Shon, 1997).

Catalogues and advertisements in leaflets, daily newspapers' fliers or monthly magazines and over telephones are used as sales tool in telemarketing. Telemarketing by department stores has advantages over specialized telemarketing companies in terms of the diversification of goods and the convenience when ordering. Currently, large department stores such as Lotte, Shinsegae and Midopa, as well as small and medium-sized department stores are jumping into the business (Sohn, 1997).

The South Korean Apparel Market

The Retail Apparel Market: Clothing and Footwear

Clothing and footwear represent an important category in the South Korean retail market, accounting for some 15% of retail sales in 1991. Clothing and footwear combined has been the fastest-growing sector of retailing as the number of working women has increased, and clothing has come to represent a major area of extra consumer discretionary expenditure. Sales of clothing and footwear from specialty outlets represented some 6,795 billion won in 1991. Clothing is generally sold through the small independent retailers, although department stores also place a high emphasis on this sector. Supermarkets and other general stores also have a significant share of the clothing market ("Republic of Korea," 1992).

Independent clothing outlets seek to attract the increasingly affluent consumers who are looking for modernized service and surroundings. The stores require heavy capital investment, however, and as a result large companies with clothing chains and chaebol-owned outlets are increasingly taking the place of independent one-store operators ("South Korea,"1995).

The Apparel Market: Imports

Some of the imported brands seen in the South Korean apparel market include Burberrys, Channel, Christian Dior, and Givenchy. There are also somewhat lower priced imported brands that appeal to youthful shoppers, including Levi Strauss, Calvin Klein, and Timberland (Yoon, 1996). Demand is growing strongly for western merchandise and international brand names, which, especially among the young, are seen as having better quality than domestic merchandise and as having a high social value. The enormous popularity of foreign goods is also contributing to the new consumer pattern in favor of expensive and luxurious goods ("Credit Cards Boost," 1996).

The decision by the U. K. retail chain Marks & Spencer, one of the world's leading clothiers, to make a large investment in South Korea, in 1996, led to economic difficulty and brought hardship to some of South Korea's largest retailers. Festivities that conveyed an optimistic attitude accompanied the franchise store opening. Of South Korea’s largest 30 companies, 21 are either in the retail business or are getting into it. This in itself should intimidate newcomers, particularly because most of these South Korean companies are diversified conglomerates that have an almost unending cash flow. Of significance in this situation is name recognition. Less than 1% of South Koreans are familiar with the Marks & Spencer brand, according to Adrejczuk, who said that the company is bringing a unique style of retailing to South Korea, i.e., selling merchandise under one brand, St. Michaels, which has been a registered Marks & Spencer trademark since 1928. In the U. K., St. Michaels is a broad-appeal brand, but in Asia it is considered a designer brand (“Marks & Spencer Opens,” 1997).

Domestic companies are striving to import internationally renowned brands under the strategy of putting a variety of brands on the market ahead of others. They believe importing various foreign brands will be greatly conducive to satisfying the diverse demands of consumers. Among the enthusiastic importers of foreign brand goods are small and medium-sized retailers. There is stiff competition between clothing makers and department stores, which precludes either from having a larger market share. They sometimes fight with each other to acquire a particular brand. For instance, Lotte Department Store and Shinwon have vied to introduce "Donna Karan New York," a U. S. designer's brand. But to make matters worse, their competitive moves may just cause brand owners to raise royalties.

Imports of consumer goods have sharply increased since 1996, reaching U.S. $5.9 billion on May 31, 1996, up 21.3% from the same period of 1995. Imports of foreign cars jumped 125%, and of fur garments 255% ("Extravagance and," 1996). Taking advantage of consumer desires for being attired in expensive foreign brand goods, clothing imports are soaring year by year. A source from the Ministry of Trade, Industry and Energy announced that ready-to-wear goods imports totaled U.S. $ 681 million in the first seven months in 1996, up 45.7% from a year before (see Table 10). In step with this, imports of foreign apparel brand names also have been on the increase. In a seven-month period, about 150 apparel foreign brands, which were imported directly or under license contracts, were newly added to the list of imported brand names. With the addition of the 150 foreign brands, about 580 imported brand names reportedly made an appearance in the domestic market in 1996 ("Clothing Imports Soar," 1996).

Table 10 Import Trends of Major Consumer Goods by Item (PDF, 6KB, Table10.pdf).

The South Korean apparel market has been tightly protected because of mercantile policy and also because of the limited purchasing power of South Korean consumers. Because the direct import of foreign-brand apparel was strictly prohibited in the past, foreign brands were introduced through license agreements, joint ventures, or technical cooperation. Apparel manufacturers, belonging to a formerly strategic industry, have begun to move upmarket, and many have licensed prestigious foreign brand names.

In 1981 foreign companies had made only three allocations for foreign brand licensing. In 1987 almost 50 foreign fashion brands were under license; royalty payments increased from $4.65 mn in 1983 to $6.5mn in 1986. South Korean companies have licenses to use brand names such as Christian Dior, Daks, Jordache, Lee, Levi's Ungaro, and Yves Saint Laurent. South Korean producers also are developing their own brand names (McDermott & Young, 1989). Table 11 shows the insignificance of the penetration of foreign brands into South Korea until 1985. Since 1986, however, the entry of foreign brands into South Korea has increased. For the period covered in the table, the majority of foreign brands came into South Korea over a six-year period, 1986-1992, owing to import liberalization, the Seoul Olympics, and surpluses in balance of payments. Although yearly trends of the foreign-brand penetration seem to follow the boom-and-bust cycles of the South Korean economy, the volume of foreign-brand apparel in the South Korean market continues to increase to date. A sharp decline in 1991-1992 can be attributed to the campaign, begun in early 1990, against the consumption of luxury foreign goods.

Foreign companies are seeking partners to secure a stable sales network in South Korea. In 1995, brands from France were in the majority with 42, accounting for 29% of the total, followed by Italy with 40, and the US with 22. As a consequence, the proportion of the three countries in total brand imports was as high as 72% in 1995. Meanwhile, in 1995 domestic apparel manufacturers put only 56 of their own brands on the market, far below the amount of imports. This demonstrates that domestic manufacturers have focused more on importing brands than on developing their own brands ("Foreign Clothing Brands," 1995).

Since 1983, European countries have successfully challenged the U.S. and Japan in importing brands. This trend can be attributed to South Korean government policy, which restricted direct arrangements for the purpose of technology transfer. Prior to the early 1980s, while restricting direct imports of foreign apparel, the South Korean government had allowed a licensing period. The U.S. and Japan were the two major countries from which technology was transferred through license arrangements or joint ventureships. With regard to the country of origin of foreign brands introduced by 1992, European countries were more represented than the

Table 11

Patterns of Foreign Apparel Brand Penetration (number of brands) by Entry Mode and by Year, 1979-1992

Year	License	Direct Export	Joint Venture	Total
1979	2			**2**
1980			2	**2**
1981	1		2	**3**
1982	3			**3**
1983	7			**7**
1984	5			**5**
1985	1			**0**
1986	2	4	4	**10**
1987	8	3		**11**
1988	8	11	2	**22**
1989	12	12	2	**26**
1990	9	12		**21**
1991	8	5		**13**
1992	6	1		**7**
Total	**72**	**48**	**12**	**133**

Note. Adapted from "Apparel Fashion Brands Survey and Analysis," by Dong-a Ilbo, 1992.

U.S. and Japan. In terms of individual countries, Italy was number one (38 brands) in the South Korean market, followed by the United States (32 brands), France (30 brands), and Japan (23) (Kim, 1995) (see Table 12).

In the first 11 months of 1995, 144 foreign clothing brands -- including 97 directly imported ones -- made a debut in the domestic market, up from some 100 observed a year before, according to the South Korea Garments Industry Association. They included 36 licensed brands and 108 directly imported ones. The import of 144 brandnames is surprising when compared with an accumulated total of 383 brandnames imported through 1994. By item, brandnames for lingerie were imported the most frequently, with 36 (25%) of the total apparel imports; following lingerie were ladies' outerwear with 34 (24%); casualwear with 28 (19%), and children’s and babies' wear with 17 (21%) (“Imported Brandnames Gain,” 1995).

Parallel Importation

The term "parallel imports" usually refers to well-known consumer goods imported into South Korea through an agent in a foreign country without passing through an agent in South Korea. Goods are imported and distributed through a different route than the channel used by the South Korean agent. This method enables the parallel importer to distribute products for much lower prices.

While parallel importing is not strictly illegal, it is often called "gray marketing," and is closely related to the practice of re-importation (Weigand, 1991). The parallel import system allows multiple businesses to import the same foreign-made item by signing contracts with a producer at the same time. Under the parallel import system, even if there is an exclusive sales company in South Korea under contract with a foreign company, anyone else can import the same goods through other distribution channels, without prior permission or consent from the exclusive licensee.

Table 12

Patterns of Foreign Apparel Brand Penetration (number of brands) by Country of Origin and by Year, 1979-1992

Year	USA	Japan	Italy	France	UK	Germany	Total
1979	2						**2**
1980	1	2					**3**
1981	1	2					**3**
1982	2	2					**4**
1983	1	1		3	2		**7**
1984	2		1	1	1		**5**
1985	1			1			**2**
1986	2	2	2	2	1	1	**10**
1987	3		6	1	1		**11**
1988	2	3	9	8			**22**
1989	4	6	7	5	3	2	**27**
1990	3	4	6	6	1	2	**22**
1991	5		5	4			**13**
1992	3	1	2		1		**7**
Total	**32**	**23**	**38**	**30**	**10**	**5**	**138**

Note. Adapted from "Apparel Fashion Brands Survey and Analysis," by Dong A Ilbo, 1992.

Parallel importing is gradually changing the distribution structure for imports in South Korea. According to Ministry of Finance officials, it was decided in November, 1995 to allow competition among local sellers to lower import prices, and to give consumers more choice and freedom when selecting brands. Licensed exclusive agents sell foreign brands at quite high prices, with import margins sometimes ten times the import price. Even though foreign suppliers may maintain exclusive agreements with single distributors in South Korea, other importers are now able to buy the same foreign products and sell them to South Korean customers in South Korea. The South Korean government has cracked down on importers of "imitation foreign brands" whose circulation might have increased following the allowance of unlicensed agents to sell foreign brands in South Korea ("Multiple Importers To," 1995).

The main advantage of parallel imports is almost always the effect that they have on prices (Homer, 1987). Reducing the price differential between authorized and gray market products is a powerful tool for reducing the attractiveness of the parallel import. The primary effect of reducing the price differential is that of undercutting the authorized retailer's price. Even without parallel imports, most manufacturers must take into account the competing companies producing equivalent goods.

Parallel imports are now estimated to exceed the value of imports handled by sole agents for such products as whiskey. Parallel imports cause the authentic branded product to enter the country in rivalry with the same product’s authorized channel or channels. This situation is harmful in that it is disruptive and destroys the basic marketing mechanisms upon which established distributorships are based. Parallel imports may be positively viewed by consumers due to lowered prices, but they present problems to license holders of name-brands who find themselves competing with the same products being sold for less.

Parallel Imports of Apparel. An increasing number of shops specializing in selling imported clothing can be found in South Korea. They are attracting consumers with comparatively low-priced, fashionable goods. Since the legitimization of a parallel import system in November 1995, such shops have been mushrooming as companies that do not hold exclusive brand licenses of any foreign brandnames have been enthusiastically pursuing the importation of foreign-brand goods. On the other hand, department stores and large discount stores fear that they may lose their customers to those specialized shops. So, those two distribution giants are making efforts to strengthen their imported goods sales teams ("Sharp Increase Seen," 1996).

With the implementation of the parallel import system, the vibrant import competition will likely intensify ("Imported Brandnames Gain," 1995). South Korea's apparel imports are projected to increase 13-fold by the year 2003, while exports may fall by almost 50% because of the reduced competitiveness of the South Korean textile and apparel industries. Exports fell from US$ 7.6 billion in 1990 to US$ 5.4 billion in 1994. Imports, including apparel imports, have been rising at a rapid pace. They reached US$ 1,014 million in 1995 from the US$ 74 million in 1989, indicating that imports are beginning to dominate the local market in all textile sectors ("Apparel Imports Increase," 1996).

Summary

This chapter presents an overview of the retailing industry in South Korea. Retailing is very different in the United States than it is in Asia. South Korea's retailing consists of predominantly manufacturing-driven retail stores that bear no distinct identity apart from being dealers in specific brands. Retailing in South Korea is overwhelmingly run by small, privately owned family shops, including small street outlets and market stalls around the country. However, the South Korean consumer market for most products is concentrated in major cities such as Seoul, Pusan, and Taegu. Having moved into the first rank of industrial nations, South Korea is now developing a retailing structure and consumer market to match.

The South Korean retail industry has been expanding rapidly since the 1980s, in part due to new investments and the introduction of modern management skills by the larger companies.

Also, the advent of new specialty department and discount stores has further accelerated the retail industry's development, as have the expansion of business districts, the spread of credit cards, and the active participation in retailing of the big companies (Lee, 1996b).

Discount stores are the latest boom in South Korea, and include the super-center, a new type of discount store that is a discount store meshed with a supermarket. Other types of retailing outlets in South Korea include department stores, "category killers," or specialty discount stores, specialty stores, and convenience stores. South Korea has also seen the advent of non-store retailing such as TV home shopping, multilevel marketing, cyber marketing, and telemarketing.

Wholesalers tend to dominate the distribution system, but distinctions between wholesalers, distributors and retailers are unclear (Quinn, 1992). The distribution industry plays an important part in the South Korean economy. At present (1997), the distribution of consumer goods is dominated by licensed dealerships.

Within the South Korean apparel market, clothing and footwear represent an important category. The importing of consumer goods has increased sharply since 1996. Demand is growing strongly for western merchandise and international brand names, and can be seen in the popularity of expensive and luxurious foreign goods.

Parallel importation, which is the importing of goods through other than licensed channels, is gradually changing the distribution structure for imports in South Korea. Parallel importing has mixed results. The main advantage of parallel imports is that they tend to drive down prices by undercutting the retailer's prices. Parallel imports are positively viewed by consumers in that they reduce prices. Parallel importing is harmful in that it is disruptive and destroys the basic marketing mechanisms upon which established importing and distribution relationships are based.

CHAPTER VI

EFFECTS OF SOUTH KOREAN CONSUMERS' "OVER-CONSUMPTION" ON THE SOUTH KOREAN ECONOMY AND ITS RETAILING INDUSTRY

Introduction

This chapter addresses the research question: What have been the effects of perceived over-consumption of luxury items by South Korean consumers on the South Korean economy, including the retailing industry?

South Koreans often perceive that domestic products are of lower quality than imported products. Therefore, the "foreign made" label has become a sign of product quality (Rhee & Lee, 1996). Today, South Koreans have a growing interest in foreign products and the money to spend on them. Patriotic, ethnocentric, and nationalistic sentiments, and distrust of foreigners are tendencies of South Koreans, which also are seen among people in other countries. Continual complaints about unfair competition, an uneven playing field, closed markets, and excessive foreign influence cross international boundaries and cause uncertainty among business people and consumers alike. Consumers are made to feel guilty for purchasing imported products, and patriotic advancements remind consumers of their duty to choose domestic-made goods over imports. The phenomenon of consumer preference for domestic products, or prejudice against imports, has been termed economic nationalism, cultural bias against imports, or consumer ethnocentrism. Shimp and Sharma (1987) defined 'consumer ethnocentricity' as "the beliefs held by consumers about the appropriateness, and even the morality, of purchasing foreign-made products"(p.280).

South Koreans' preference for foreign products is paradoxical, considering South Korea's strong nationalism and its long history of boycotting foreign products. Patriotic, ethnocentric, nationalistic, and even xenophobic sentiments have grown and faded among South Koreans over time. In part because of the occupation by U.S. armed forces, South Koreans love American products, according to Mr. Kon Kim, a native of South Korea and president of K & K trading in Needham, Massachusetts. "The appetite for American products has been growing since the Korean War ended" ("South Korean Market," 1994, p. 9). During 1954-1957, economic aid from the U. S. provided a new economic experience for South Korean consumers. U. S. assistance helped South Korean consumers out of poverty, and also created South Korean consumers' fondness for foreign, specifically American-made, products.

"Over-consumption" of Imported Luxury Items

The reaction of South Korean consumers to newly available imported products, since South Korea began to open its market to the world in 1988, has led to what some call over-consumption of imports, which couples with the problem of exports growing at a far slower rate than imports. The growth rate of consumption typically exceeds that of income during the contraction phase of a business cycle, but recent consumption growth in South Korea is more dramatic than during previous economic slump (Kwak, 1996). It has been shown that South Korean consumers have a marked preference for imported luxury items and a low interest in local-made products and that they tend to regard imported products as better, no matter what the prices are. Spending by urban South Korean households showed an annual increase of 13.6% during the 1991-95 period, compared, for example, with an annual average increase of 1.1% in urban Japan ("Consumer Market: Spending," 1996). In other words, urban household spending rose 12 times faster than that in Japan from 1991 to 1995. According to the results of a public opinion poll on South Koreans' consumption behavior, which was conducted by the National Economic Education Center (NEEC), an agency of the Korean Development Institute (KDI), South Koreans are viewed as tending to overspend, largely due to "imitative" consumption. The

NEEC survey asked 1,431 South Koreans in their 20s or above what they thought about South Koreans' spending and what the respondents' own spending habits were. South Korean youth showed a distinct lack of frugality, saving little and spending heavily (Sohn, 1996a).

South Korean consumers, as they travel abroad more and buy less expensive and better-quality goods, are perceiving that domestic producers have exploited them. This is leading to a growing consumer revolt at home and greater willingness to demand foreign products (Burton, 1995). Imported novel products encourage more spending and discourage saving. This issue became highly publicized because many big businesses of South Korea take the lead in importing and marketing luxury consumer products ("Reckless Luxury Imports," 1996). South Korean consumers have been on a massive spending spree in recent years (Chessman, 1992). A taste for foreign brands is spreading widely across the nation. Imported goods - from toothpicks to clothes to expensive furniture - are flooding department stores and even traditional markets. Imported blue jeans preferred by South Korean youth sell quickly at department stores, despite the high price of U. S. $120. Foreign commodities increasingly occupy the shelves of small shops and stationery shops in front of elementary and high schools, replacing homemade articles. Imported stationery and toys account for about 50% of items sold at most stationery shops near elementary schools in Seoul. Even expensive British kitchenware and French cosmetics, along with cheap Chinese garments, are found even in the conventional markets in the poor sections of town, the so-called "taldongnae." ("What We Have," 1997).

Some evidence suggests that South Korean consumers are continuing to show a high preference for imported goods. A survey conducted by KCCI on the competitiveness of major imported merchandise reported that 67% of the respondents preferred imported goods to domestic goods. (KCCI did not report the sample size.) It was pointed out that the primary reason the survey's respondents gave for preferring imported goods over domestic goods as their perception of the higher quality of imported goods compared to domestic goods, rather than more favorable price levels of imported goods or South Korea's inability to produce certain goods (see Table 13). The survey also found that consumer preferences in the case of textile goods were affected by the degree of recognition of trademarks and brands. Along with the high consumer preferences for imported goods, “patriotism index” has been declining, which means that the consumers are gradually becoming less reluctant to purchase non-domestic products; it is projected that this will greatly influence the diffusion of imported commodities in the domestic market. The non-price competitiveness of imported products is rising as a whole, and the price differences with domestic products are gradually narrowing (“The Competitiveness Of,”1996).

Table 13 Comparison, by Percentages, of South Korean Consumers' Reasons for Preference for Imported Goods over Domestic Goods from 1994 to 1996 (PDF, 5KB, Table13.pdf).

Colgate toothpaste, Kellogg cereals, various kinds of imported glasses and cups, Kraft cheese, Maxwell House coffee, Japanese snacks, and so on are displayed at store entrances to attract the attention of buyers. The reason is quite obvious: profits from home-made goods are about 30%, while those from imported goods reach 50%. According to data from the Office of Customs Administration, imports amounted to U.S. $136.6 billion from January to November 1996, a 10.8% increase over the U.S. $123.3 billion recorded in the same period in 1995 ("What We Have," 1997).

Brand Consciousness

South Korean consumers are brand-conscious. "They love to buy things that are approved by their friends, colleagues, and relatives. South Koreans tend to be followers, not leaders” (“South Korean Market,” 1994, p. 7). South Korean consumers tend to favor name-brand imports. For example, they buy brands such as Spam, Ritz, Coca-Cola, and Gucci. They will pay whatever it costs, when it has a world-renowned name ("South Korean Market," 1994). The National Economic Education Center’s public opinion poll found that South Koreans are more interested in name brands than in product usefulness (Sohn, 1996a). Consumers can choose from a set of brands that includes foreign-manufactured or licensed products covering every conceivable product category, from foods, toys, and apparel to automobiles, computers, and industrial robots (Gibney, 1994).

The New Generation in South Korea

The older generation in South Korea suffered through war and the hardships of rebuilding a nation, whereas the new generation of South Koreans now can enjoy all the modern-day conveniences of an advanced country. The age group from the teens to about age twenty is classified as the new generation of South Koreans. They can be characterized as individuals who are assertive, are open to new ideas, and value their individuality, including married women who choose to dress and look like single women (known as "missys") and young married couples who prefer to enjoy their own lives before becoming parents. In a broader sense, the new generation encompasses a wide age group of people who will not simply accept society's traditional ways (Kim, 1995b).

The younger and older generations have noticeably different attitudes with regard to their consumer preferences. While those in the older generation, who have lived through the hard times, tend to select products based on quantity and cost considerations, the younger generation, who live in an abundant modern society, value image and quality. For example, instead of needing South Korean food, they would rather have Western-style food; instead of generic-brand clothing, they will pick out more expensive Calvin Klein underwear. Even daily necessities are no longer merely items to be purchased as needed, but as a means of self-expression and satisfaction (Kim, 1995b).

People of the new generation value themselves as individuals and are intent on expressing this feeling. They have intense desires to distinguish themselves from the “crowd."

Therefore, regardless of what others might say, if they want to wear micro-miniskirts or ripped jeans or color their hair, they will do so without hesitation. No matter how expensive a particular item might be, once they feel it is something that they have to have, then they will buy it more often than not. They are preoccupied with the latest trends and figuring out what is "in." Fortunately or otherwise, the fashion industry is happy to supply them with endless varieties and choices. Just being able to pick out a certain style or brand serves to heighten their sense of individuality. Younger generation South Koreans are extremely fashion-conscious. In 1995, Seoul Marketing Data (SMD) released a survey of some 1,200 South Korean men and women, aged 19 through 29, in regard to their fashion habits. The survey results showed that a majority of the women wear different clothing every day (as opposed to wearing the same thing two days in a row). About half of the women responded that they follow fashion trends, and 60% said they read fashion magazines or watch fashion-related programs on TV (Kim, 1995b).

The consumer preferences of the South Korean younger generation have a significant influence on domestic retailing, particularly sectors concerned with fashion, music, and entertainment. This is occurring at a time when competition is increasingly fierce from foreign-made products. This follows the trend of the younger generation to be more "globalized" than the previous generations. In other words, a trend that is popular in Los Angeles is also likely to be popular in Berlin, Rio de Janeiro, and Seoul (Kim, 1995b).

Consumer Attitudes in South Korea

According to a major Western textbook (Engel, Blackwell, & Kollat, 1978), consumer attitudes toward products, and the corresponding marketing practices associated with these products, have been shown to be very important influences on purchasing behavior in the marketplace. In a consumer study by Schooler and Wildt (1968), as the price difference between a foreign and a domestic good was altered in favor of the foreign good, some of the consumers switched to the foreign good against which they had been originally biased. Attitudes tend to change over time. Pride of ownership and consumer satisfaction with the product are strong factors in such changes in attitude (Darling, 1981).

A survey conducted by Frank Small and Associates found that South Korean consumer attitudes toward imported products are distinctly positive ("Globalizing Provincialism," 1995). A survey in South Korea by the U.S. Chamber of Commerce in 1995 showed that attitudes had become considerably more positive in a very short space of time: in 1988, only 34% of adult respondents said they were willing to buy foreign products, whereas in 1995, 62% said they would (Hutton, 1995). According to a Korean Association of Housewives Clubs' survey, housewives with higher education preferred imported goods ("Women With Higher," 1996). (It should be noted that none of the publications that reported these surveys indicated the sample size.)

For South Korean consumers, the manufacturers' traditional domination of the nation's retail market has meant high prices. Prices on items such as household appliances and electronics have been sometimes shockingly high, but consumers had no recourse but to pay ("Foreign Merchants Change," 1996). Protected markets are one reason for the high cost of living, but excessive taxes are also a factor: consumption taxes can add as much as 45% to the price of some goods. Despite all this, South Koreans are buying more, while starting to demand better quality and lower prices (Hutton, 1995). South Koreans in the 1990s may still feel that they should buy local goods, or refrain from conspicuous consumption, but patriotic frugality is no longer compulsory. South Koreans are quickly becoming accustomed to the related Western-style consumerism, and it remains to be seen how rapidly they will be able to match the related Western cultural norms, including credit cards and discount shopping (Hutton, 1995).

Another attitude shift is shown by the discount stores springing up in the suburbs, a sign that consumers have become used to variety and reasonable quality and are now looking for competitive prices as well. Some might say it is about time that South Korean consumers were introduced to the benefits of price competition. According to a recent government survey, many everyday goods are significantly more expensive in South Korea than in the UK, the U.S., and elsewhere in Asia (see Table 14). South Koreans even pay more for some things than the residents of the world's most expensive city, Tokyo. Perhaps not coincidentally, many of the products that cost more in Seoul than in Tokyo are on South Korea’s list of banned Japanese imports - such as TVs and cameras (Lee, 1996). As the South Korean market is opened, however reluctantly and gradually, consumers should benefit.

Table 14 Price Comparison of Eight Major Cities (PDF, 8KB, Table14.pdf).

Frugality Campaign

South Korean consumer groups launched a frugality campaign in mid-1996 to improve the nation's balance of payments (Zarocostas, 1997). The frugality campaign, also known as the austerity campaign, is a voluntary movement by civic groups, encouraged by the South Korean government. The campaign is intended to encourage rational and reasonable consumption patterns by way of efficient use of economic resources and reduction of environmental waste. It aims to reverse the nation's consumption patterns seen as based in lavishness and extravagance. The campaign includes pledges by big conglomerates to curb imports, restrictions on overseas spending, and anti-import exhortations by groups and associations such as the Korean Central Council of Nightspot Owners (Blustein, 1997).

The frugality campaign began to gain in influence in 1996, as it became clear that the South Korean economy was in far worse condition than anyone had suspected. In 1996, South Korea’s GDP annual growth fell to 6.8% from 9% in 1995. The current accounts deficit shot up 165% to US $23.7 billion, the second largest in the world after the United States' in 1997 (Lee, 1997).

The combination of these indicators has led many in the general public, as well as in the business sector, to regard the situation as a crisis and to take counter actions, giving birth to the frugality campaign. Fundamentally, South Koreans increasingly believe that the country's current consumption patterns should be rationalized. South Korean media and civic groups, some financed by the government, mounted the campaign against "luxury" imports after a call in the summer of 1996, by President Kim Young Sam, for less "luxurious consumption" to help cut the record U. S. account deficit (Burton, 1997b).

To many, consumer imports are, by definition, “luxury” goods ("Loosening The Drag," 1994). In South Korea, more than half of consumer items has been categorized as “luxurious.” Consumer preferences and extravagance expanded imports of consumer goods and also resulted in a widening trade deficit. The government’s definition of luxury goods includes electronic products, home appliances, cosmetics, golf clubs, clothing, and cars (Burton, 1997c). The European Union Chamber of Commerce in South Korea has said that South Korea should update the list of "luxury goods" in line with the South Korean GNP. TV sets, video camera recorders, compact disc players, audio systems, coffee makers and vacuum cleaners, which the South Korean government considers luxury products and on which it charges heavy taxes, are nowadays considered standard household goods by many consumers in South Korea ("EU Chamber Urges, 1995).

Imports of “luxurious” goods, such as passenger sedans, high-priced furniture, cosmetics, electronics, and amusement equipment, during the first seven months of 1997, amounted to U. S. $3.77 billion, or 43.8% of the seven-month overall imports of consumer goods totaling U. S. $8.59 billion. The ratio of “luxurious” consumer items to overall imports of consumer goods rose from only 23.5% in 1985 to 41.2% in 1990 and again to 44.9% in 1995. Moreover, the ratio of medium-priced consumer goods, such as textiles and footwear, to overall imports of consumer items went up from 3.9% in 1985 to 6.6% in 1990, 13.3% in 1995 and 13.7% in the first seven months of 1996. By major commodity group, sharp rises were noted in the January-July 1996 imports for animal fur apparel (up 326.6% from a year before), passenger cars (up 78.1%), golf equipment (up 68.8 %), cosmetics (up 48.5 %), and furniture (up 39.5%). At the same time, the ratio of passenger cars to overall imports of consumer products grew from 1.2% in 1990 to 3.0% in the first seven months of 1995, that of high-priced apparel from 0.6% to 3.2%, and that of cosmetics from 0.8% to 2.2% ("Luxury Goods Account," 1996). Although the government estimates that imports of products classified as "luxury goods" grew by 48% to U. S. $2 billion in 1996, they accounted for only 8.8% of imports (“The Death of,” 1997).

The Frugality Campaign as Anti-Import Strategy

South Korea’s trading partners increasingly regard South Korea’s frugality campaign as an anti-import strategy similar to the one that was introduced in 1990. That earlier campaign failed when government officials urged companies to stop importing consumer goods in a bid to improve the trade balance. The trade minister was fired as a result of protests from South Korea’s trading partners (Clifford, 1991). In the more recent frugality campaign, the South Korean government has emphasized that the frugality campaign is led by the civic sector and not by the South Korean government, and according to Choe Jong Hwa, Economic Counselor at the South Korean Embassy in Washington, the intention is to combat extravagant spending in general, not just spending on imports (Blustein, 1997).

Foreigners maintain that they have evidence of anti-import practices by government employees in South Korea. If the frugality campaign were regarded as an anti-import drive abroad, despite South Korea’s strenuous protestations, it would adversely affect the nation’s foreign trade with major partners. Government officials have countered foreign criticism by saying that it is aimed at rationalizing consumption rather than discriminating against foreign products. However, the campaign has hurt imports, particularly cars and alcoholic beverages (Lsarocostas, 1997). Such tactics as the Bank of Korea’s threats to investigate excessive credit card spending overseas and reports that the Office of National Taxation will audit those who spend too much on so-called luxury goods make the exporter's sales job all the more difficult ("Loosening the Drag," 1994).

The European Union (EU) decided against challenging South Korea's alleged frugality campaign as an anti-import drive at the World Trade Organization. Its decision came after the South Korean government issued an official statement in 1997 that it would not discriminate against foreign imports. The EU had threatened to take the matter of the frugality drive to the WTO's dispute settlement panel unless South Korea made an "acceptable effort" by May 15, 1997. Leon Brittan, vice president of the European Commission, was quoted as having said that South Korea's official statement (to treat both domestic and foreign goods equally) was an "acceptable solution," adding, however, that the European Union would carefully monitor whether South Korea was abiding by its official commitment. South Korea's official statement not to penalize foreign products, however, invited strong domestic criticism for bowing to foreign pressure. The Citizen's Movement Centre for anti-over-consumption, the group leading the frugality campaign, threatened to stage a national boycott against foreign products if the EU and U.S. continued to press South Korea on the issue (Burton, 1997a). Consumer groups also have threatened to boycott foreign goods if and when foreign countries continue to meddle in internal, voluntary, and civilian-led campaigns to save more and spend less ("EU Decides Not," 1997).

The South Korean government opened an import grievance center at the Ministry of Finance and Economy in April 1997 in response to the mounting foreign criticism of Seoul's alleged anti-import campaign. The Division of International Cooperation was designated to handle all grievances pertaining to imports. Three officials, one each from the Ministry of Agriculture, the Ministry of Trade, Industry and Energy, and the Ministry of Health and Social Welfare, were assigned to the unit in order to ensure efficient and effective service through close cooperation with the other ministries concerned. The Ministry of Finance and Economy officially asked field officials engaged in trade-related administration in South Korea to take precautions with their work to avoid action which might be perceived as discriminating against imported goods. The letter said the South Korean government is concerned about the possibility of the negative impact of an overly sensitive response from foreign governments to the frugality campaign, adding that the South Korean public may perceive harsh outside criticism against the frugality campaign as unjustified foreign pressure. The South Korean government indicated that the media and civic groups have reacted to South Korea's economic troubles in their own ways, adding that their diagnosis seems to be that the problem lies with excessive consumption practices such as indiscriminate energy use and food waste. It is in this context that some civic groups voluntarily initiated frugality campaigns aimed at discouraging extravagant consumption and encouraging reasonable consumerism. The letter added that the Korean government, while recognizing such positive aspects of these campaigns as the cultivation of healthy consumerism and the reasonable use of resources, holds the firm view that they should not degenerate into campaigns targeting foreign goods, which would restrict fair and free competition. Having thoroughly looked into these claims, the South Korean government has come to the conclusion that these false contentions were the product of misunderstandings mostly on the part of foreign export industries and their import counterparts in South Korea ("Govt. Opens Import," 1997).

Wealthy people and businesses have devised tricks to evade sanctions for challenging the ongoing frugality campaign. With the current accounts deficit hitting a record high, voluntary and involuntary frugality drives have been initiated in every sector of South Korean society; however, the campaign has brought about more negative than positive effects in reducing the deficit. First of all, as the economy declines, owners of deluxe foreign cars are careful about whether or not the tax office will investigate their earnings for potential retaliatory taxes. As a strategy to avoid state penalties, buyers often choose not to buy foreign cars directly; instead, they lease cars from leasing companies. Another negative effect of the frugality campaign is the government crackdown on buyers of duty-free goods in South Korea. The Korea Customs Service (KCS) has asked duty-free shops to check the identity of visitors, saying many ineligible people frequent the shops, which are exclusively reserved for travelers. As it becomes more difficult to buy foreign goods at domestic duty-free shops, South Korean travelers have resorted to buying foreign goods in duty-free shops overseas. This has resulted in widening, not narrowing, the trade deficit, although the amount is quite negligible ("Businesses Devise Tricks," 1997).

Summary

This chapter has addressed the research question: What have been the effects of perceived over-consumption of luxury items by South Korean consumers on the South Korean economy, including the retailing industry? From its inception, the South Korean consumer movement has had a strong nationalistic basis; however, in part because of the occupation by U. S. armed forces following the Korean War, South Koreans often have a preference for American products. South Koreans often perceive that domestic products tend to be lower in quality than imported products. Also, South Koreans tend to be brand conscious, and tend to favor name-brand imports. The reaction of South Korean consumers to newly available imported products, since South Korea opened its market to the world in 1988, has led to over-consumption, which couples with the problem of exports growing at a far slower rate than imports. In particular, the younger generation in South Korea is fashion conscious and tends to follow fashion trends. The consumer preferences of the South Korean younger generation have a significant influence on domestic retailing, particularly in sectors concerned with fashion, music, and entertainment.

One response to the worsening condition of the South Korean economy was to launch a frugality campaign to discourage indiscriminate over-consumption of luxury items, many of which are foreign imports. The frugality campaign has negative implications for future economic development in two respects. Politically, it highlights the priority of short-term interests, with little regard for credibility in the international market; and it will not have a significant effect on the trade deficit, in that consumer goods account for only 12% of imports (“Oxford Analytica Asia,” 1997). The frugality campaign was met with negative reactions from world trade organizations and foreign investors.

CHAPTER VII

EFFECTS OF FOREIGN DIRECT INVESTMENT, THE TRADE DEFICIT, AND THE PRICE GAP BETWEEN LOCAL GOODS AND IMPORTS ON THE SOUTH KOREAN ECONOMY AND ITS RETAILING INDUSTRY

Introduction

This chapter addresses the following research questions: what have been the effects of foreign direct investment on the South Korean economy, including the South Korean retailing industry?; what have been the effects of South Korea's trade deficit on the South Korean economy, including the South Korean retailing industry?. The chapter also discusses the effects on the South Korean economy and retailing of the price gap between local goods and imports.

South Korea's rapid rise to the ranks of an industrialized country has brought difficulties as well as benefits. Rather than enjoying a long and gradual evolution, South Korea's entry into the global marketplace has been abrupt and has brought with it economic extremes. These extremes have ranged from the poverty of post-occupation Korea, to the lavish consumer spending of more recent times to the current economic crisis facing the nation. South Korea has had to face coming to terms with the political and economic adjustments that are required as a result of the opening of its markets to foreign trade. In other words, South Korean industries have been striving to maintain equilibrium in an unstable environment. International policies have propelled South Korea rapidly into the global marketplace, and the economy has had to attempt to adjust to the international pressure and policy decisions. This chapter includes a discussion of the international policies that have impacted South Korea’s market-opening, and also discusses three significant factors that have influenced South Korean retailers as a result of South Korea's rapid globalization. The factors include the increase in foreign direct investment

(FDI) in South Korea, the price gap between imports and local goods, and South Korea's sizable trade deficit.

International Policies

Economic policy has maintained a progressive trend toward South Korea’s market-opening. South Korea has been making steady progress in opening its markets and globalizing since 1988. Domestically, the government has been increasing the import liberalization ratio; externally, it has been globalizing domestic industries by investing overseas. It could be said that the present government has realized that South Korea can no longer rely on foreign loans as it pursues a more sophisticated economic structure. Liberalization in South Korea came about through recognition of the benefits to the domestic economy of opening the market to greater foreign participation. Virtually all industrial products are now exempt from import restrictions. Agricultural products remain heavily restricted, but in 1989 the government decided to liberalize many areas by 1991, and the target of 1997 for the removal of all remaining agricultural import barriers was realized (Pauley, 1990).

The General Agreement on Tariffs and Trade (GATT)

After South Korea became a member of the GATT in 1967, it pursued an export-oriented development strategy until the late 1970s. Before the end of the mid-1970s, South Korea had not adopted positive market-opening policies due to the chronic deficit on the balance of payments. After 1983, the South Korean economy grew rapidly and the trade balance became positive. From that time, the nation began a program to open and internationalize the South Korean economy to improve domestic industrial competitiveness, to maintain harmonious trade relations with trading partners, and to play a role matching its position as one of the world's 12 major trading countries. By agreement with the GATT/Balance Of Payment committee in October

1989, South Korea announced that remaining import restrictions would be gradually eliminated or brought into conformity with GATT provisions by July 1, 1997. In accordance with the 1989 consultations with the Committee on the Balance of Payment Restrictions, South Korea notified GATT in March 1991 of its pre-announced liberalization schedule (a total of 133 items) for 1992-1994 as the first-step notification. It announced its second step and final notification in April 1994 (a total of 150 items) ("Trade & Industry," 1996).

The Uruguay Round (1986-1993) and GATT

The Uruguay Round of the General Agreement on Tariffs and Trade (GATT) is the most extensive global trade agreement in history. This agreement, negotiated by 124 countries under the auspices of the GATT, was completed on December 16, 1993 (“The World Trade,” 1994). Because of South Korea‘s overregulated and closed financial system, and because its economic wealth has been concentrated mainly in the hands of a few large chaebol, the Uruguay Round, which emphasized intellectual property rights, standards harmonization, foreign direct investment, and trade in services, proved to be particularly demanding for South Korea (Spaeth, 1995).

World Trade Organization (WTO)

The World Trade Organization (WTO) is a single institutional framework encompassing the General Agreement on Tariff and Trade (GATT) and the agreements and legal instruments negotiated in the Uruguay Round (“Developing Countries And,” 1994). By January 1, 1995, when the new WTO, the successor to GATT, became operational, most negotiators had given the final approval to the agreement (“The World Trade,” 1994).

The WTO is speeding up the integration of world trade as the main axis of the world trade order, promoting competition across borders, and rapidly advancing the global economy. On the other hand, world trade has evolved with great complexity in its expansion and reinforcement of regionalism, in spite of the fact that multi-nationalism has strengthened since the beginning of the WTO. As the basic paradigm of the world trade order has changed from exclusive protection for national interests to trade relations, countries have fundamentally changed their policies. Every country cannot but cooperate in order to survive under the fierce competition, pursuing policy changes in consideration of the mutual dependency between countries. In particular, the end of the cold war has led to fast advancement in technology, transportation, telecommunications, and information systems; however, the rapidity of globalization is impacting the degree of effectiveness of trade policies. Export drive policies, aimed at accumulating national wealth through the protection of local industries, cannot contribute to maximizing competition under globalization.

The Organization for Economic Cooperation and Development (OECD)

In late March of 1995, South Korea formally filed an application to join the OECD as part of President Kim's new five-year economic plan for 1993-1997 ("What OECD Membership," 1996). On December 12, 1996, South Korea became the 29th member of the OECD, with the submission of an admission document to the French government (“Korea Becomes 29th," 1996). Korea signed the agreement to join the OECD 19 months after it submitted its application. South Korea has so far remained committed to economic liberalization and structural reforms as part of its globalization plan.

The United States and Europe have pushed South Korea to be more open in its bond market and cross-border capital flows. With OECD membership, South Korea may be able to diffuse foreign market-opening pressures. The United States has traditionally pressured South Korea into opening particular sectors, but other OECD members, including European countries, may oppose such unilateral pressure from a particular country. OECD membership is an occasion for westernizing the domestic system and practices, and it should have the effect of inspiring competition. OECD entry and trade liberalization will eventually make access to imported goods easier.

With the free flow of capital into South Korea, businesses that lack competitive advantage face the danger of being pushed out of the market. In the service sector, South Korea is likely to see increasing inroads by foreign distributors into both retail and wholesale services. With market-opening taking place ahead of schedule, structural changes in the financial sector will soon become more and more apparent as banks and securities trading firms move in. The U. S. is expected to increase pressure on South Korea to further open its agricultural, service, and automobile markets in association with funds from the International Monetary Fund ("U.S. to Hike," 1997) (see Table 15).

Foreign Direct Investment (FDI) in South Korea

South Korea’s Foreign Capital Inducement Act (FICA) in 1998, defines foreign investment as the acquisition of an ownership of shares of a domestic company in order to establish a continuous economic relationship with such company, including such purposes as participating in the management of the company (Lee, 1998, p. 56). The purpose of FICA was to contribute to the sound development of the national economy through effective inducement and protection of foreign capital, including foreign direct investment. The role of foreign direct investment (FDI) in the South Korean economy remained low compared to other newly developing countries for many years, only reaching 1% of the total domestic capital formation between 1979 and 1991, despite the increase of foreign direct investment since the latter half of the 1980s (Islam & Chowdhury, 1997). Until the early 1980s, South Korea followed an extremely cautious policy, which was a result of a distrustful attitude towards FDI (Hill, 1990). This is due to the fact that South Korea's foreign capital inducement policy was directed

Table 15

South Korea's Trade Policy, 1997-1998

Types	Measures	Timing
1. Trade-related subsidies	• Eliminate four trade-related subsidies by end-1998 (committed to WTO)	• Submitted to National Assembly a bill to abolish three trade-related subsidies, and abolish one subsidy administratively at the time of National Assembly Approval, expected in March 1998
2. Import liberalization	• Phase out Import Diversification Program (presently covering 113 items) by end-1999 (committed to WTO) a. Liberalization of 25 items b. Liberalization of additional 40 items c. Liberalization of additional 32 items d. Liberalization of remaining items • Reduction of number of items subject to adjustment tariffs from 62 to 38 • Harmonization of import certification procedures with WTO standards and strengthening of their implementation.	• December 30, 1997 • July 1998 • December 1998 • June 1999 • Ongoing
3. Financial services liberalization	• Binding of liberalization agreed with OECD as part of commitments to WTO	• Announced in January 1998

Note. Adapted from "The Second Memorandum on the Economic Program agreed Between the Korean Government and the IMF," 1998, January 12, The Korean Economic Weekly, (473), p.5.

primarily at the introduction of foreign governmental and commercial loans rather than at foreign direct investment. Negative views against foreign invested enterprises arising from the past Japanese colonial era were also a principal factor. South Korea's attitude towards FDI has changed significantly in recent years. With the globalization of the domestic economy, negative attitudes toward foreign direct investment have diminished. The number of areas open to foreign investors has increased considerably and the aim was to achieve 95% of areas open to foreign investment by January 1997 (Islam & Chowdhury, 1997). Foreign direct investment is expected to add vitality to the South Korean economy through expansion of knowledge-based and high value-added industries, the transfer of high technology, and the advance of the industrial structure ("Foreign Direct Investment," 1996) (see Table 16).

Foreign Direct Investment in the 1980s

Foreign direct investment in South Korea showed no significant change during the period from the mid-1960s until the mid-1980s. Since the mid-1980s, foreign direct investment in South Korea has undergone a dramatic increase. FDI inflows, which were a little more than U. S. $500 million on average for the years leading up to 1986, had almost doubled to U. S. $1 billion annually by the early 1990s. The robust growth in foreign direct investment in South Korea in the latter half of the 1980s was attributable both to the booming domestic economy and to improved market access following the implementation of foreign direct investment policies. After peaking in 1988, foreign direct investment declined. This decline was attributable in large part to the following factors: increased labor disputes and the ensuing wage hikes in the late 1980s that made South Korea less attractive as a site for low-cost labor; a rise in real estate prices and wages; and difficulties facing foreign-investment enterprises in producing funds in the domestic financial market which worsened the business environment for foreign investors. South Korea's foreign direct investment climate was relatively less attractive compared to the Southeast Asian countries ("Foreign Direct Investment," 1996).

Table 16

The Evolution of South Korea's Foreign Investment Regime

Time	South Korea's Foreign Investment Regime
1960-1983	**Initial introduction and development of foreign direct investment (FDI)**
1960	The Foreign Capital Inducement Act was enacted.
1970	The South Korean government imposed various restrictive measures on FDI.
1984-1995	**Liberalization of foreign direct investment.**
1984	The South Korean government initiated numerous liberalization measures.
January, 1990	Abolition of approval conditions, such as the export requirement.
December, 1992	Adoption of the Notification-oriented System.
June, 1993	Five-Year Foreign Investment Liberalization Plan introduced to open up 210 business.
1994	The South Korean government established a one-stop shop for foreign investors.
March, 1994	Landmark simplification of requirement procedures for investment.
April, 1994	De-regulative initiation on land acquisition and use.
September, 1995	Plan for Favorable Environment for FDI to make the FDI system consistent with international standards.
November, 1995	Five-Year Liberalization Plan for Foreign Direct Investment to open up 48 of the 105 restricted business sectors.
May, 1996	The number of fully or partly restricted business sectors for foreign investment amounted to 120 compared to the 1,148 open for FDI.
1996	A new Foreign Direct Investment Law introduced before the end of 1996.
February, 1997	The Foreign Capital Inducement Act was amended to become the "Act on Foreign Direct Investment and Foreign Capital Inducement."

Note: Developed from Foreign direct investment. (1996). Seoul, Korea: K.C.C.I. Kim, H. (1997, February 3-10). Foreign direct investment trend in Korea. The Korea Economic Weekly, (427), p. 12

Foreign Direct Investment in the 1990s

The South Korean government has been pursuing the liberalization of foreign direct investment since the 1960s. South Korea discouraged foreign participation in its economy, but is now reviewing its earlier policies. In the wake of globalization, South Koreans have realized that foreign investment will become the driving force behind economic development (Hicks, 1997).

The rapid liberalization efforts by the South Korean government parallel the OECD's spirit of global economic liberalization. The government recognizes that its current liberalization plan falls short of the level of liberalization achieved by the advanced countries (Yoo, 1996b). With the launch of the new government in 1993, liberalization policies on FDI were implemented with great enthusiasm and speed. Thus, all FDI in South Korea, apart from a few business sectors, now only require the filing of notification, which is indicative of South Korea's willingness to liberalize its direct investment environment for foreign investors. The plans were revised in May 1991 and November 1995 to expedite the FDI process and broaden the scope to accommodate the latest changes in a rapidly globalizing market (Kim, 1997).

In 1994, foreign investment inflows increased again due to the government's policy of foreign investment stimulation, the expansion of business categories eligible for foreign investment, and the simplification of foreign investment procedures. The South Korean government facilitated procedures for foreign investors by instituting the Korea Foreign Investment Service (KFIS), in 1994, in order to further simplify the approval procedure (Islam & Chowdhury, 1997). In 1994, 414 foreign investment applications were approved, totaling 1,317 million U. S. dollars, a 26.2% rise in the number of projects and a 26.1% increase in the amount involved compared to that in the preceding year (see Table 17). Foreign investment inflows thus returned to the 1989 level ("Foreign Direct Investment," 1996).

Table 17 Foreign Direct Investment by Year (1990-1997, Jan.-Apr.) (PDF, 5KB, Table17.pdf).

By April 1996, the liberalization ratio for FDI into South Korea, gauged by the number of industrial sectors open to FDI, had reached 95.1%. In the manufacturing sector specifically, the ratio stood at 99.5%, a level that was close to complete liberalization. As of May 1996, the number of fully or partly restricted business sectors for foreign investment amounted to 120 out of 1,148 open for FDI (Kim, 1997). A new Foreign Direct Investment Law, which was introduced before the end of 1996, sets the principles for the liberalization of FDI and includes comprehensive incentives to encourage investments in South Korea. To invest in the approved areas of business, foreign investors will need only to report their intention to any foreign exchange bank in South Korea; except for certain exceptional cases, the processing time under the notification system will not exceed three hours. South Korea's voluntary undertaking of FDI liberalization will not be limited to these aspects. The South Korean government is planning to upgrade the country's FDI environment by improving relevant rules, regulations, and procedures to conform to international standards ("Foreign Direct Investment," 1996).

In 1997, foreigners were able to open shops in South Korea for the resale of arts and antiques, employment agencies, job placement, private detective and security and guard services, and the manufacture of explosives and pyrotechnic products. They also were able to engage in the retail and wholesale grain business, the manufacture of starch and starch products, air or land freight handling, inner city transportation, and groundhandling of aircraft services. In addition, offset printing and commercial printing by stencil plates or similar plates are newly opened to foreign direct competition. The government also opened such sectors as marine fish farming, the hatching of aquatic animals, plant and sea fishing, as well as the manufacture of lubrication oil and greases, the reprocessing of petroleum derivatives, and legal representation and legal services ("Foreign Direct Investment," 1996).

In January 1997, the liberalization ratio for FDI reached 96.6% for the entire economy, while remaining at 99.5% for the manufacturing sector. Out of the total 1,148 business areas in South Korea, 1,121 (97.6%) were opened to foreign investment as of March 1997 (Kim, 1997) (see Table 18). During the first quarter of 1997, the inflow of foreign investment in South Korea totaled U. S. $2.12 billion, according to the Ministry of Finance and Economy (MOFE). This represents a 372% increase from 1996. The first quarter figure surpassed the U. S. $1.94 billion recorded for the entire year of 1995, and accounted for 66.3% of the U.S.$3.2 billion recorded in 1996 ("FDI Inflow Dramatically," 1997) (see Table 17). Total foreign direct investments in South Korea amounted to U.S.$1.56 billion in April 1997, recording the highest monthly figure ever. The growth in foreign investment has been on a steep rise since 1993. The year-on-year amount gains stood at 16.8% in 1993, 26.2% in 1994, 47.4% in 1995 and 65% in 1996 ("Direct Investments From," 1997) (see Table 17).

Table 18 Foreign Investment Liberalization as of March 1997 (PDF, 5KB, Table18.pdf).

Foreign Direct Investment in the 2000s

The South Korean government has announced its plan to partially or fully open 47 business sectors, including law firms, newspaper printing, petroleum service stations, inner city buses, and all types of vocational training schools, to foreign investment from 1997 through 2000. This will push the nation's foreign direct investment liberalization ratio to 97.5% by the year 2000, leaving only 44 industrial sectors off-limits to foreign direct investment out of the 1,148 business categories listed in the South Korean Standard Industrial Classification ("Foreign Direct Investment," 1996).

By the year 2000, the nation's liberalization rate should be 98%. Only a few manufacturing industries relating to South Korea's unique history, heritage, and culture will remain closed (Yoo, 1996b). Market-opening will be permitted for 1,130 projects among the total of 1,148 business sectors available for FDI, and the restricted sectors will be reduced by 44 areas by the year 2000 (Kim, 1997). Completing these steps will bring the country's market liberalization ratio to 98.4% in 2000 from 95.1% in 1996.

After the year 2000, only such sectors as tobacco processing, medical insurance, aviation, horse racing, casinos, electricity supply, electrical power generation, real estate brokerage, broadcasting, and social security businesses will remain closed to foreign investors. Also to be opened are those sectors whose liberalization will not have any negative impact on the economy due to lack of foreign interest and the strong competitiveness of local firms ("Foreign Direct Investment," 1996).

Foreign Direct Investment by Nations

By nation, in 1997 foreign direct investment in South Korea from the U.S. and the EU jumped 902.3% and 684.7% respectively, but foreign direct investment from Japan declined by 7.3% since 1993 ("Business in Korea," 1998; "Foreign Direct Investment," 1997a) (see Table 19). Investment from the U.S. and EU countries is increasing, while that from Japan's economy is on a downward trend. This is because Japanese investment has mainly targeted labor-intensive industries ("Foreign Direct Investment," 1996).

The foreign trade volume of the People's Republic of China (PRC), in 1993 stood at US $ 195.8 billion with exports of US $ 91.8 billion and imports of US$ 104 billion. The PRC's position in world trade moved from the 32nd place in 1978 to the 11th place in 1993 ("People's Republic of China," 1998). The PRC has become an important trading partner of South Korea. Developed countries serve as major suppliers of machinery and capital goods to the South Korean market, while developing countries, including the PRC, supply more than 50% of textiles ("The Competitiveness Of," 1996). According Shimbun, trade between the PRC and South

Korea in the first quarter of fiscal 1995 amounted to US $ 3.075 billion, a 59.5% increase over the previous year. South Korea is now the PRC six largest trading partner, and projections are that it will become an even bigger trading partner in the future (Shimbun, 1995).

Table 19 Foreign Direct Investment Trend in U.S. $ million by Country (PDF, 5KB, Table19.pdf).

Foreign Direct Investment by Industries

As the South Korean market is being liberalized under the WTO system, foreign investments are chiefly focused on the distribution and tourism businesses (Sohn, 1997). Since 1994, more foreign investments have been made in services than in manufacturing. Investments are largely focused in hotels and distribution businesses, with 39.1%, in terms of investment amount, followed by finance at 23.8%, trading at 9.9%, and wholesale/retail at 7.1% in 1996 ("Foreign Direct Investment," 1996). Perhaps the most significant growth in foreign investments over the past several years has been in the services sector. Foreign investment in services only accounted for 30% of the total until 1992, but has since increased dramatically, making up 50% and 70% of all foreign direct investment in 1993 and 1994, respectively. With the recent recovery of foreign investment in the manufacturing sector, the distribution of foreign investment in the service sector and manufacturing sector again reached balanced levels in 1995 ("Foreign Direct Investment," 1996).

Foreign direct investment in the manufacturing sector jumped 42.2% to U.S. $916 million during January-August 1996, and foreign investment by nonmanufacturing industries rose 28.8% to U.S.$729 million ("Foreign Investment In," 1996). As of the end of 1996, foreign investments in manufacturing accounted for 61.2% of total foreign investment cases and 60% of invested capital, and investments in services were 36.4% of cases and 39.5% are of invested capital ("Foreign Direct Investment," 1996).

Foreign Direct Investment in the South Korean Retail Market

The South Korean retail market has experienced a significant increase in foreign investment with the establishment of several new "hypermarkets" chains. In addition, foreign consumer goods companies that have operated in South Korea for many years as joint ventures are now buying out their local partners to take further control over marketing, distribution, and brand management. Foreign importers of consumer goods are also actively investing in warehousing and distribution (Brown, 1997). The drastic increase in foreign investment is attributed to huge investments by a Korean-American businessman who wants to build and set up discount distribution outlets in South Korea.

A U.S. distribution giant, Price Costco, and South Korean retailer Shinsegae group materialized the first direct investment deal in 1998. Price Costco became the leader of major foreign distributors, such as Makro and Carefour, for direct investment in South Korea. Price Costco is expected to be the third foreign discount distributor to become established in South Korea, following Makro of the Netherlands and Carefour of France (“Price Costco To,” 1998).

South Korean apparel firms, which have used world-renowned brands under license agreements, have experienced difficulties because many of their partners have refused to renew agreements that had expired ("Apparel Cos. To," 1991). An increasing number of well-known foreign firms are exerting efforts to sell their products directly to take advantage of the opening of the local retail market, instead of working in joint ventures ("Famous Foreign Makers," 1996). According to apparel industry sources, on March 11, 1991, foreign garment firms providing their South Korean partners with world-famous brands, including Givenchy, Lanvin, Nina Ricci and Christian Dior, were reluctant to renew their license agreements. Instead, they either requested that their South Korean partners import finished products, or they directly advanced into the South Korean market after the garment market opened up in July 1991. Samsung Co. failed to renew its license agreement with Givenchy, which expired in April 1991. Zone Co., which had produced ladies' swimsuits bearing the Nina Ricci brand, also has not been allowed to use the brand since July 1991. Lanvin refused to renew its license agreement with Cheil, which expired in December 1991. At the end of 1990, the Christian Dior brand had been licensed for use for only its underwear, and the Lanvin brand was withdrawn from South Korea ("Apparel Cos. To," 1991). Industry sources said companies like Benetton, Levi's, and Louis Vuitton were all moving swiftly to set up their own shops to grab a greater share of the market. The baggage manufacturer Louis Vuitton, for instance, established direct sale outlets aimed at foreign tourists, especially duty-free shops in department stores. Benetton of Italy, which makes clothing for children, teenagers, and adults, has joined with Art Box, to engage in virtual direct retailing through its Ben Art outlets ("Famous Foreign Makers," 1996).

Recent instances of such direct investment by international firms are also found in Levi Strauss Co. International. In May 1993, Levi Strauss terminated its contract with its local seller and established Levi Strauss Co. South Korea under the direct supervision of its international headquarters. Through this new distribution system, Levi Strauss was capable of making a more systematic approach toward its retail clients. The Levi Strauss Co. International saw the potential for untapped growth in the South Korean jeans market - evidently one of their reasons for deciding to set up a South Korean office. Levi Strauss Co. South Korea aims at keeping up with the growth of the South Korean market by bringing different styles and products into South Korea; seventy-five percent of the products that are sold in South Korea are manufactured locally (Yoon, 1996). For two consecutive years, Levi Strauss had the best selling jeans in the South Korean market. Despite the over 100 shops directly operated by Levi Strauss around the country, the customers' preference for these American jeans has not resulted in lowering prices. Levi's South Korean customers still have had to pay three times as much for the Levis 501 jeans directly imported from the U.S. Strangely enough, in addition, the lengths of the Levi's 501 jeans exported to South Korea come only in one length - 34 inches. These jeans were described as a hidden factor for South Korea's 1995 fashion boom where the overly lengthy jeans literally "swept" the streets of Seoul. (The average height of South Korean women in their twenties is

160 cm.) Even with 12-cm high heels, the 34-inch long Levi's dragged on the ground. Even so, it became fashion, exemplifying the power of the Levi's brand name.

Joint Ventures in Foreign Investment

Until recently, South Korean regulations did not generally authorize foreign equity over 50%, with the exception of high tech or export oriented investment (Chaponniere & Lautier, 1995). The local firm most likely to be chosen as a foreign partner was one which possessed assets complementary to the competitive advantage of the entrant. Since foreigners were not authorized to own land, a local partner was first sought in order to secure land rights. Foreign enterprises also looked for a partner with a suitable distribution network or other specific assets (Chaponniere & Lautier, 1995).

Foreign Direct Investment and South Korean Perceptions

The South Korean people do not always have a positive perception of foreign direct investment. They are very proud of their domestic industrial development and are uncomfortable with a foreign entity taking a significant share of a product or service in the local markets (Brown, 1997). They are also worried about causing a boomerang effect and possible damage to domestic industry ("Internationalization of Korean," 1992). But, the South Korean people are becoming very cosmopolitan and demanding access to global products and services. The South Korean government recognizes its responsibilities to open the market and has significantly broadened its definition of "good" foreign direct investment (Brown, 1997).

Despite a steady rise, foreign direct investment in South Korea hovered around slightly over half the amount of South Korean overseas direct investment in 1996, raising a concern over a detrimental effect on dominant industries. The figure contrasts with U. S. $3.05 billion in South Korean overseas direct investments posted for the January-July period ("Foreign

Investment In," 1996). FDI's small role in South Korea results from government restrictions designed to limit foreign control of the economy and to discourage domestic consumption of international-brand-name consumer products, and possibly from the chaebol's presence where the chaebol rather than foreign multinationals "unpackage" new technology (Hill & Jones, 1984).

The Price Gap Between Local Goods and Imports

Over time, the price gap between domestic and imported goods has narrowed. Although the price level of local goods is 20% more than that of goods from developing countries, it is 40% lower than that of imported products from developed countries; however, factors other than price cause many South Korean consumers to prefer foreign-made products. These factors include the level of technology, durability, after-service, and the quality of basic materials.

Seoul, Korea, is the third most expensive city to live in among eight major cities in the world, coming after Tokyo and Paris. With the price of 50 daily necessities in Seoul indexed at 100, those in other cities - Tokyo, Paris, Taipei, Singapore, London, New York, and Los Angeles - averaged 93.9, making Seoul's figure higher by 6.1% points, according to a recent survey conducted by the Ministry of Finance and Economy (see Table 14). Staffers of the Consumer Protection Board visited department stores and discount stores in eight cities from February through May in 1996 to compare the prices of 50 daily necessities. The price comparison was made on retail prices, including taxes. According to the survey, it was 30% costlier to buy a vacuum cleaner, audio equipment, cassette player, camera, mattress cover and blue jeans in Seoul than in the other cities studied. Also, in Seoul, such products as milk, bread, women's clothing, and glasses frames were 10-20% more expensive than in the other cities. The Ministry of Finance and Economy listed the following as causes of the high prices in Seoul: an inefficient distribution system, manufacturers' monopoly of sales networks, lack of competition among distributors of imported products, high land prices, high wages, and high logistics costs (Lee, 1996). Protected markets are one reason for the high cost of living, but excessive taxes are also a factor; consumption taxes can add as much as 45% to the price of some goods (Hutton, 1995).

The local manufacturers' domination of South Korea's retail market has meant high prices. Prices on items such as household appliances and electronics are sometimes extremely high, but consumers have had no recourse but to pay ("Foreign Merchants Change," 1996). In South Korea, the high cost of production, combined with rigid regulations, make South Korea's products much more expensive than the foreign counterparts. South Korean consumers, as they travel abroad more and buy less expensive and better quality goods, are concluding that domestic producers have exploited them. This is leading to a growing consumer revolt and greater demand for foreign products (Burton, 1995). It has been argued that imported novel products encourage over-spending and discourage saving. This issue became highly publicized since many big businesses are the ones who take the lead in importing and marketing luxury consumer products ("Reckless Luxury Imports," 1996). The procurement of capital equipment -- which also has increased sharply, though not as drastically as consumer goods -- is obviously an investment. The problem arose when exports grew far more slowly than imports. Despite all this, South Koreans are buying more, while starting to demand better quality and lower prices (Hutton, 1995).

South Korea's Trade Deficit

The rapid growth of imports in 1967 meant that South Korea could not improve her trade balance significantly, despite the more rapid growth of exports from a much smaller base. During the 1960s, South Korea ran large trade deficits, averaging over 10% of the GDP. Initially, these deficits were mainly financed through unilateral transfers from the U.S., and later increasingly through foreign borrowing. The trade and current account balances deteriorated following the first oil shock in 1974, but then improved as the terms of trade recovered in the second half of the decade. The second oil shock, political instability, and a bad agricultural crop caused a widening of current account imbalances and a deep recession in 1980. Account imbalances were gradually reduced in the following years. Trade deficits increased somewhat between 1965 and

1983, although there were many fluctuations in the interim years. The net balance on goods and services combined showed a similar trend during this period (see Table 20). The total foreign debt gradually dwindled from U.S. $46.7 billion at the end of 1985, to U.S. $29.4 billion four years later (Lee, 1997). A large real depreciation of the currency and the fall in oil prices in 1986 helped trade and current account balances move into large surpluses, thus allowing South Korea to substantially reduce its external indebtedness. In response to a rebound in the real exchange rate and to rapid growth of domestic demand, the trade and current account balances reverted to deficits in 1989 (Giorgianni & Milesi-Ferretti, 1997).

Table 20 Major Trends in South Korea's Balance of Payments: Current Account Balance 1960-1983 (PDF, 11KB, Table20.pdf).

In general, during the expansion phase of a business cycle, the import growth rate exceeds the export growth rate, resulting in a worsening trade balance; whereas, in a slowdown phase, the import growth rate falls below the export growth rate, bringing about an improvement in the trade balance. During the recent economic slow-down in 1997, the export growth rate fell below the import growth rate, resulting in an increased trade deficit. Before the 1980s, the South Korean import growth rate remained below the economic growth rate. In the mid-1980s, the former outstripped the latter. This tendency became more pronounced in the 1990s. The elasticity of imports with respect to exports jumped to 4.17 during the period between the first quarter of 1990 and the fourth quarter of 1996. Several factors affected the increase in import elasticity. One was the opening of the South Korean domestic market; much of the domestic demand growth was satisfied by imports from foreign countries. The other is increased dependence on foreign suppliers of the equipment and machinery for new investments. In the early 1990s, large scale investments were made in major industries, including semiconductors, automobiles, and steel ("Opening The Domestic, 1997).

Market-opening has meant an increase in the South Korean trade deficit. As the South Korean market has become increasingly more open to foreign imports, South Korean consumers had demanded more expensive luxury goods. Retailers need to import more goods to satisfy the tastes of consumers, thus creating competition with domestic goods, which are often perceived as being of inferior quality. This has an adverse effect on South Korean retailers who commonly carry their own branded products, and on the South Korean economy in general.

During the 1990s, South Korean trade and current account imbalances have until very recently been more modest than in past decades (Giorgianni & Milesi-Ferretti, 1997). South Korea had begun to accumulate a deficit in international trade since its full-fledged market-opening in 1994 (Cheong, 1996). In trade with the U.S., South Korea posted a surplus in 1993, but it sustained a deficit with the U.S. of U.S. $1 billion in 1994, followed by deficits of U.S. $6.2 billion in 1995 and U.S. $5,052 million in the first half of 1996 ("Trade deficit with", 1996). South Korea's current account balance has continued its downward trend partly due to running up a huge trade deficit of U.S.$ 12 billion in 1996. In 1996, the GDP growth fell to 6.8% annually from 9% in 1995. Most seriously, in 1997, the current account deficit rose drastically by 165% to U.S. $23.7 billion, the second largest in the world after the United States'. A large shortfall in export earnings pushed the country's total foreign debt above the U.S. $100 billion mark (Lee, 1997).

South Korea was the only nation in East Asia that acquired a trade deficit with the U.S. during the first six months of 1995, including a U. S. $600 billion deficit in June alone, according to the South Korea International Trade Association (KITA). South Korea ran up the third largest trade deficit among the U.S. trading partners in June 1996, behind the Netherlands and Australia, which recorded U.S. $830 million and U.S. $640 million shortfalls, respectively ("ROK Only East", 1996). In trade with the U.S., exports during a five-month period in 1996 reached U.S. $9,528 million (up 9.1% from a year before) against imports of U.S. $13,845 million (up 16.1 %), thus leaving South Korea with a trade deficit of U.S. $4,317 million. Imports from the U.S. of primary products rose from U.S. $2.6 billion in 1994 to U.S. $4.37

billion in 1995, thus playing a leading role in increasing the trade gap between the two countries in South Korea's disfavor ("Trade deficit with", 1996). The deficit in two-way trade with the U.S. reached U.S. $27.4 billion, or 37% of the total deficit in the Jan.-March quarter of 1997 (Shon, 1997).

During the first two months of 1997, South Korea's current account deficit amounted to U.S. $5,591 million, up 50.9% from the U.S. $3,703 million deficit recorded in the same period of 1996. South Korea's current account deficit came to U.S. $2,448 million in February 1997 alone, a decrease of U.S. $695 million from January, but an increase of U.S. $469 million from the same month in 1996 (Lee, 1997). The nation sustained a trade deficit of U.S. $7,477 million in the first quarter of 1997, some U.S. $3.3 billion more than the U.S. $4,169 reported a year earlier ("Trade Deficit Reaches, 1997). The anticipated total foreign debt level in 1997 represented about 27% of the nation's GDP, a sharp rise from the 22.9% estimated in 1996. This unfavorable trend is not expected to change any time soon (Lee, 1997).

Even without the analyses and forecasts of government economists and researchers, the negative outlook for the economy is obvious in the complaints of local consumers, as well as manufacturers and traders who point to slow exports and an influx of foreign-made goods into domestic markets. Economic projections remained uniformly discouraging at least for 1998 (Lee, 1997).

Imports from abroad have increased greatly in the wake of South Korea's agreement to extensive market-opening, in the spirit of both universal free trade and reciprocity with trading partners. Meanwhile, South Korea's products are being priced out of international markets with the arrival on the world trade scene of other newly industrializing nations.

The International Monetary Fund (IMF)

In addition to South Korea's economic problems associated with its trade deficit, at the end of 1997 the so-called 'Asian Flu' swept across the east Asian economies. For well over a decade, people all over the world watched the so-called "Asian Tiger" nations with amazement. The economies of these nations were expanding dynamically and were flooding the Western nations with continuous stream of low-price goods. Then, suddenly, this situation changed. One by one, some of the "Asian Tigers", including Taiwan, Japan, Hong Kong, Indonesia, Thailand, and Malaysia, experienced crises. Their values of their currencies dropped precipiticiously in the foreign exchange market. Positive economic growth slipped into recession and then declined into deep depression. The resulting "Asian flu" now threatens to infect the Western nations. The Japanese economy officially entered a recession; South Korea is closing banks and raising interest rates in compliance with a $55 billion IMF bailout package; and the GNPs of Malaysia and Hong Kong actually shrank in the first quarter of 1998 (Vincent, 1998).

South Korea, hit hard by the twin crises of currency devaluation and corporate bankruptcies, appealed for "financial rescue." On November 21, 1997, Deputy Prime Minister and Minister of Finance and Economy Lim Chang-yuel announced that the South Korean government had decided to approach the IMF for financial assistance to help overcome the recent difficulties in the financial and currency markets ("The IMF Bailout, 1997). South Korea had to commit itself to substantial changes in the laws and regulations relating to its economic structure, including policies affecting corporations, or chaebol (Lee, 1998). Officials at major conglomerates and their lobbying group, the Federation of Korean Industries, noted that after the IMF loan to South Korea materialized, the United States government could be expected to push for the further opening of the South Korean market. Mr. Chung Hyun, senior researcher at the Federation's International Business Department, said that the IMF bailout loan may not lead to the immediate call for full market-opening, but was likely to boost foreigners' demand for wider opening of the corporate bond market. He also said that developed economies were likely to raise their calls for further opening of domestic markets after the national economy gained some strength through financial and industrial restructuring, after the loan. Gong Byeong-ho, an outspoken supporter of a market economy, said the industrial countries would particularly demand liberalization of those sectors in which they enjoyed advantages and which they have said have been too closed and complicated. Gong said that their call for market-opening would become stronger than ever after the completion of a critical phase of restructuring. Service, automobile, and other high-tech industries, as well as the agricultural sector, have been cited as the likely major targets of the U. S. and other advanced nations for additional liberalization (Chun, 1997).

In the second memorandum on the economic program agreed between the South Korean government and the IMF on December 24, 1997, the South Korean government promised implementation of more reformative measures at an accelerated pace than it did in the first memorandum which was agreed upon December 3, 1997. The second memorandum stipulated that South Korea would accelerate measures to open the economy to imports and eliminate trade-related subsidies in order to increase competition and efficiency in the domestic economy (see Table 15).

Summary

South Korea's rapid modernization brought difficulties as well as benefits, including economic extremes ranging from the poverty of post-occupation Korea to the excessive consumer spending of modern times. South Korea has had to adjust politically and economically to the opening of its markets to foreign trade. This chapter includes a discussion of the international policies that have impacted South Korea's market-opening, and also includes discussions of three significant factors that have influenced South Korean retailers as a result of rapid globalization. These include the increase in foreign direct investment (FDI) in South Korea, the price gap between imports and domestic goods, and South Korea's sizable trade deficit.

Economic policy has maintained a progressive trend toward South Korea's market-opening. South Korea became a member of the General Agreement on Tariffs and Trade (GATT) in 1967. In accordance with the 1989 consultations with the Committee on the Balance of Payment Restrictions, South Korea informed GATT, in March, 1991, of its liberalization schedule, which contained a total of 133 items. It notified GATT of its schedule for liberalizing 150 items in April, 1994. Also of significance for South Korea's trade liberalization were the Uruguay Round of the GATT (1986-1993), agreements made with the World Trade Organization, and South Korea's joining of the Organization for Economic Cooperation and Development under President Kim's economic plan for 1993-1997.

The number of areas open to foreign investors has increased considerably. Foreign direct investment is expected to add vitality to the South Korean economy through expansion of knowledge-based and high value-added industries, the transfer of high technology, and the advance of the industrial structure (Foreign Direct Investment," 1996). However, the competition with locally-made and foreign-made goods has been narrowing. At the same time, quality considerations are causing the gap in non-price competition to widen.

South Korea's deficit in trade with the U. S. and other advanced nations has been widening at an accelerating pace. Previous economic slowdowns were accompanied by an improvement in the trade balance brought about by a decline in demand for imports. The current economic slow-down is accompanied by a deterioration of the trade balance that has registered a record deficit. The combination of a steep cut in the export price of semiconductors, rising imports of consumer goods, and dwindling exports of shoes, textiles, and leather goods resulted in the estimated U.S. $19 billion trade-balance deficit in 1996 (Ahn, 1997). The main reasons for the large trade deficit are first, the loss of export price competitiveness due to the weakness of the Japanese yen and drops in the prices of South Korea's major export commodities; and secondly, further liberalization and wide opening of the distribution and commodity markets that are acting to boost imports of consumer durable goods (Cheong, 1996).

CHAPTER VIII

EFFECTS OF CHAEBOL ON CURRENT RETAILING

Introduction

This chapter addresses the research question: what have been the effects of "chaebol," or large conglomerates, on the South Korean economy, including the South Korean retailing industry?

A distinctive feature of South Korean industrial development has been the part played by the "chaebol," or large conglomerates. Production is heavily concentrated in the hands of these large business groups, the largest 15 of which probably account for two fifths of the GNP. Their impact is seen everywhere in products from semiconductors to toothpaste, medical instruments to cars and ships, and in services - hotels, construction, transportation, insurance, and banking. More than 50 corporate groups are usually referred to as chaebol, but there are four which are much larger than the rest: the Hyundai Group, the Samsung Group, the Daewoo Group, and the Lucky-Goldstar Group. Each of these four includes a general trading company (chonghap sangsa) and a range of industrial and service activities (McDermott & Young, 1989).

South Korea's economic miracle based on big businesses is well documented and praised in the economic-development literature as an example of successful institution building to facilitate rapid economic growth (Amsden, 1989; Chang, 1993; Johnson; 1986; Luedde-Neurath, 1986). Compared with other countries at similar stages of development, the average size of the South Korean firm is quite large. Thirteen South Korean firms were listed in the 1991 Fortune 500, compared with one each from Taiwan, Malaysia, and Thailand ("1991 Fortune 500," 1992). The large size of South Korean firms is no accident. From the beginning of the 1970s, the South Korean government felt that South Korean firms could compete in the international market only if they were of a certain minimum size (Kim & Leipziger, 1997). Most of South Korea's chaebol started from small shops or factories after the Korean War (Amsden 1989; Steers, Shin, & Ungson, 1989).

Definition of Chaebol

Yoo and Lee (1987) defined a chaebol as "a business group consisting of large companies which are owned and managed by family members or relatives in many diversified business areas" (p. 50). Most of the South Korean conglomerates, or chaebol, were established by families, who still control them and wield considerable authority ("Keeping It In," 1995). Key executive positions are often held by family members instead of professional managers ("Keeping It In," 1995). The chaebol have traditionally cooperated among themselves, in part because the sons and daughters of the founding families are intermarried (Nakarmi, 1992). The South Korean chaebol are characterized by strong family control and are also very large (Amsden 1989; Steers, Shin, & Ungson, 1989). Many South Korean chaebol adopt certain tactics, such as gaining advantageous new family ties through marriage, to secure their existence and to maintain the family's dominance in management (Jones, 1987; Lee, Yoo, & Lee, 1991; Sakong 1980). Therefore, a chaebol can be viewed as an economic group, which is defined as a "multicompany firm that transacts in different markets but which does so under common entrepreneurial and financial control" (Leff, 1978, p. 663).

History and Characteristics of Chaebol

The history of the chaebol is essentially a history of South Korean economic development, and their meteoric growth is a phenomenon of the 1960s and late 1970s. The origins of many of these groups go back to the 1960s when their founders started in business. The emergence of the chaebol in their present form was triggered by the aftermath of the Korean

War when many entrepreneurs re-entered business as traders, and the progression into manufacturing was assisted by massive U.S. aid in the wake of the ending of hostilities (McDermott & Young, 1989). Ever since its recovery from the Korean War, South Korea's economy has been dominated by tightly knit groups of military-backed technocrats and top politicians who have given preferential treatment to powerful business families. The heads of these business groups, or chaebol, in turn contributed campaign funds to the politicians (Nakarmi, 1992).

To understand the changes in South Korea’s economic policy and the ways in which these changes will influence the ability of the chaebol to become true global competitors, it is necessary to consider how such firms evolved structurally. There are several key characteristics that stand out when investigating a typical South Korean firm. These include reliance on family control and management, an entrepreneurial orientation, strong paternalistic leadership, centralized planning and coordination, close business-government relations, and the importance of strong school ties (see Figure 6). Unlike their Japanese counterparts, families, through stock ownership, tightly control many South Korean companies. In addition to family ownership, there also has been active family participation in company management. Another traditional characteristic of these South Korean firms is their distinct entrepreneurial orientation, which can be traced to the personalities of the founders and the nature of the South Korean society. Many chaebol are managed by one central paternalistic figure. The CEO, often the founder, typically assumes personal responsibility for the performance of every aspect of the firm. Chaebol have historically been associated with the existence of a central planning function whose representatives work closely with the group chairmen in reaching decisions and developing strategic plans for further corporate actions. Until recently, the economic foundations of modern South Korea rested firmly on a close and mutually beneficial relationship between business and government. A final characteristic of the chaebol is the importance they place on educational credentials. In South Korea, the university one attends is crucial to one’s later advancement in a career. While there are a number of excellent schools and universities in South Korea, the more prestigious the institution, the better it is for one’s career (Steers, Shin, & Ungson, 1989; Ungson, Steers, Park, 1997).

Figure 6 Traditional Characteristics of the Chaebol (PDF, 4KB, Figure6.pdf).

The diversity and size of the chaebol are similar to those of the zaibatsu, Japan's pre-war big business groups. It is worth noting that for some South Koreans the term chaebol has the same negative connotations that they often associate with the terms zaibatsu in Japan and conglomerate in the United States. These negative attributions have resulted in large part from the perception that some of the chaebol accumulated their wealth either because of unfair advantage or government connections (Steers, Shin, & Ungson, 1989). The chaebol have an important difference from the zaibatsu. The Japanese conglomerates are no longer tightly linked groups owned and operated by founding families (Kraar, 1989) (see Table 21).

Table 21 Comparison of South Korean Chaebol and Zaibatsu (PDF, 5KB, Table21.pdf).

The South Korean economy is organized into large vertically structured units with roots deep into the small-business sector via subcontracting that serves to produce high levels of efficient linkages and modern levels of efficiency (Redding, 1997). Most of the groups have general trading companies (GTCs) and construction companies as their major business lines. Diversified business groups are common to all late industrializing countries, but those in South Korea are especially large. The Fortune list of 500 international private non-oil producing firms in 1986 included ten from South Korea and only seven from all other developing countries combined (Pare & Woods, 1987).

In many respects, the chaebol can be thought of as the counterpart of the U.S. multi-divisional firm, the only difference being that the South Korean "divisions" happen to be legally (though by no means functionally) independent entities. Further, in the U.S., a company is credited with its own manufacturing establishments and the manufacturing establishments of the subsidiaries and affiliates it acknowledges (Brock, 1959). The chaebol generally served the South Korean economy well in the 1960s and 1970s when, favored by the government with cheap credit, import barriers, and political favors, they led the country's urgent industrialization ("South Korea’s Conglomerates," 1991).

The Effects of the Chaebol on the South Korean Economy

One theory on the increasing concentration of economic power in a small number of hands in a rapidly growing economy states that economic concentration is a natural result of economic growth. Economic modernity means taking advantage of economies of scale in technology, organization, and marketing. It requires placing resources in the hands of those entrepreneurs who have shown themselves most capable of survival in the international arena. The rapid rise in business concentration is thus merely one inescapable facet of the transformation of a growing economy from a primitive economic structure to one which is modern and internationally competitive (Jones, 1987). Initially, South Korean government policy relied on the development of the chaebol, in order to achieve economies of scale and realize competitive advantage in export markets. However, concern over the continuing growth of the chaebol---a growth known locally as "the octopus syndrome" because of the way big business has tentacles extended in every direction---is not a new issue (Cho, 1993). South Korea's miraculous economic growth and rapid rise to the ranks of an industrialized nation have carried with them considerable costs.

The chaebol are highly diversified horizontally. To the extent that they benefited from organizational economies of scale by reducing the required entrepreneurship per unit of output, the South Korean economy must also have gained. On the other hand, their positions are so dominant-either monopolistic or oligopolistic-in many of South Korea's industries that they cause economic inefficiencies of all sorts (Sakong, 1993). The chaebol have grown too large and diversified to compete effectively abroad, and their domination of the domestic economy prevented the growth of small and medium-sized businesses. Some chaebol, such Hyundai and Samsung, now have 40 to 50 different businesses. Internal trading within chaebol groups reduces the ability of small businesses to sell products and services to the conglomerates (Burton, 1993).

As of 1985, the 30 largest big business groups (chaebol) produced 40% of South Korea’s total manufacturing value added (Lee, 1990), and as of 1989, the largest 50 business groups comprising 520 companies produced 16% of South Korea’s GNP (Korea Investors Service, 1990). In 1985, the thirty largest business groups (comprising 270 firms) processed 40% of total tangible fixed assets and hired 17.6% of the total employees in the South Korean manufacturing sector (Cho, 1990). These 30 largest business groups contributed 38.5% of South Korea’s total commodity exports in 1997, somewhat lower than the 41.3% in 1985 (Economic Planning Board, 1989).

The South Korean Government and Chaebol

The success of the chaebol has depended greatly upon the strong support of the state in channeling cheap credit to favored chaebol, in coordinating investment and export strategies, and in controlling the labor force (Jones & Sakong 1980; Kim 1988; Koo 1987; Lee, Yoo, & Lee, 1991; Wade 1990). Thus, although the chaebol are large employers and exporters, they do not control the South Korean economic system in isolation, but still depend extensively upon the state. Similarly, their high level of diversification is partly due to state pressures to invest in heavy industry in the 1970s (Amsden, 1989).

South Korea's quantum leap towards economic prosperity has not come without controversy. Like other Asian powers, government ministers realized by the 1950s that, in order to build an industrialized economy, economic power would need to be concentrated in the hands of a few. By encouraging the creation of chaebol---a few select conglomerates that would centralize manufacturing and R&D for the entire nation, the government became the single most influential economic and moral investor in private industry. It favored giants such as Hyundai with incredibly generous tax concessions and investment vehicles, arguing that such subsidies were the only way that South Korean products could compete in global markets against high-volume producers such as the Japanese (Barton, 1992). The government also promoted the growth of the chaebol through its heavy involvement in certain investment decisions. When projects did badly, it had little choice but to get involved. It did so by either an outright bailout or by asking another group with a sound financial base to take over the unsuccessful venture (Kim & Leipziger, 1997).

The chaebol were assured of growth in the 1970s because of their close ties with the Park Chung-Hee government, through membership in the Federation of Korean Industry (FKI), and as the chosen agencies for the implementation of export-led industrialization (ELI). Most of today's leading chaebol established monopolistic bases during that period. During the "Five Year Economic Development Plans" the chaebol were assigned at first to light industries, such as garments, footwear, domestic electronic appliances, and construction, but later, after the Vietnam War (1964-1973) had generated sufficient capital, to large scale heavy and chemical industries. International competitiveness was guaranteed for the chaebol by their General Trading Company (GTC) status which provided them with loans and export subsidies (Leggett, 1997).

In South Korea, the government makes diversification or investment decisions concerning important industries, and this was particularly true during the earlier stages of economic development before the early 1970s. Thus, private corporations have followed the government's directions or arrangements without protest in order to be included in the targeted growth industries. It is clear that the South Korean government's leadership in economic development policy and the close relationship between government and business are responsible for South Korea's phenomenal economic growth; however, this early traffic control by the government gave the chaebol a good excuse for their later "octopus like" expansion (Lee, Yoo, & Lee, 1991). The tentacles of the chaebol reach into almost every business, from shipbuilding to car-making, to finance, to electronics, convenience stores, and satellite broadcasting ("The Koreans are," 1996).

Since 1981, policymakers have tried to scale-back the power of the chaebol, through limiting bank lending, restricting investments in affiliated companies, and channeling credit to small and medium-sized industries (Clifford, 1988). The government's intention of reducing the power of large corporations was not designed to open up the local market further to foreign multinationals. Rather, it was designed to strengthen local firms ("A Mammoth Task," 1993). One of the things that allowed the chaebol to carry on as usual was the heavily protected domestic market. When rising costs and recession in the West slowed exports in the late 1980s, South Korean manufacturers were able to turn to the domestic market to make up for some of the sales lost (McGrath & Ahn, 1994).

In October 1996, in a bid to subdue the conglomerates' out-of control expansion overseas, the government ordered them to finance at least 20% of their foreign investments from local sources, either through retained earnings or by selling assets. The government decided that, from 2001, the chaebol would no longer be allowed to guarantee the debts of their affiliated companies ("Good Breeding," 1996). The chaebol have tended to expand continuously because of their preferential access to bank loans, which has undermined efforts to operate the groups on a cost-effective basis (Burton, 1995a). Firms that once manufactured clothes began to make TVs and ships. Construction companies set up brokerages and petrochemical factories (Olivier, 1995). The government, anxious to force the chaebol to increase direct financing from capital markets, has imposed a ceiling on the percentage of total loans that banks can give to the chaebol (Burton, 1995a).

The South Korean government has never enjoyed an easy relationship with the chaebol. Together the 30 largest chaebol, which include such household names as Hyundai, Samsung, Lucky-Goldstar (LG), and Daewoo, account for around three quarters of the country's economic output. They depend on the government for license to operate freely in their chosen areas, while the government depends on them to deliver the wealth that South Koreans have come to expect (Montagnon, 1995). In 1993, President Kim hosted luncheon or dinner meetings for the chairmen of most of the nation's 30 largest conglomerates to listen to their complaints and to motivate them to increase their capital investments ("President Kim Fails," 1994). The authorities thus have to be cautious in pushing for reform that will reduce the chaebol's grip on economic power (Montagnon, 1995).

The chaebol structure is slowly changing due to government pressure at home and South Korea's need to adapt to a more competitive business environment abroad. The chaebol have been criticized for spreading their resources too thinly by competing in many of the same industrial sectors, from cars and ships to construction and electronics. The intense competition has reflected the personal rivalry among the chaebol’s family owners (Burton, 1992). South Korea wanted to reduce the concentrated economic power among the chaebol by forcing family owners to cut their shareholdings in the industrial groups ("Keeping It In," 1995). The owners of the nation's 30 leading industrial conglomerates have spread their equity holdings over about 15 "specially-related" persons, such as family members, relatives, and executives ("Chaebol Owners Spread," 1997). LG, which has 13 listed companies among its subsidiaries, maintains an average of 48 specially-related persons per listed firm, also marking the highest such number. Among the family-controlled chaebol, the Daewoo Group has “utilized" the largest number of corporate executives having a special relationship with the owner. Having spent years supporting its leading companies in various ways, South Korea is now forcing them to be more self-sufficient ("Chaebol Owners Spread," 1997).

On January 18 of 1994, the Ministry of Trade, Industry and Energy announced that the country's top 30 chaebol would do as the government had asked and concentrate on their core businesses. The order to restructure came in the latest five-year economic blueprint, launched in July 1993. The 10 largest chaebol were allowed to name three sectors each, and the next 20 to name two sectors ("Taming the Chaebol," 1994). The intention was to continue to use the chaebol as vehicles for economic development by lifting credit restrictions on the designated core companies, while squeezing credit given to other subsidiaries in compliance with the government's goal of reducing the size of the chaebol (Burton, 1992). Lotte has chosen the sectors of distribution as well as the production of food, beverages, and chemicals; Samsung, which lobbied hard to be allowed to diversify into car making, eventually ended up with electronics, machinery, and chemicals. Firms that play by the new rules will continue to receive preferential state-backed financing. Those that disregard the rules will not. The government claimed it has three clear aims: to encourage competition and foster small businesses; to wrest power from the old industrial dynasties and hand it over to professional managers; and, above all, to stem the "octopus-like growth" of the chaebol into unrelated areas. The size of the chaebol and their broad diversification into nonrelated products have allowed them to survive the hardships of late industrialization, and to penetrate the lower end of numerous foreign market major investments in targeted industries. Whereas South Korea has depended heavily on foreign loans, it has historically entertained almost no direct foreign investment outside the labor-intensive sectors (Amsden, 1989). The five largest chaebol are all involved in shipbuilding, semiconductors, financial services, and textiles---industries with few obvious synergies. The top 10 conglomerates each currently operate in an average of 11 different areas; the next 20 operate in an average of seven. By contrast, Japan's top 40 business groups on average operate in only five industries ("Taming the Chaebol," 1994).

One advantage of the South Korean system is that it promotes effective co-ordination among the dozens of businesses that the chaebol operate. However, the centralization of power increases the chances for strategic blunders since it discourages consultation with subordinates who may have a more accurate view of market conditions ("Keeping It In," 1995).

Chaebol and the South Korean Retailing Industry

The South Korean government recently included retailing, especially in the country's developed markets, in the designation of the major business groups' core industrial sectors that could receive financial credits and tax benefit. As a result, investment by large business conglomerates in retailing is increasing, offering improved distribution opportunities to the apparel business, including exports ("Exporting U.S. Textiles," 1997).

The South Korean chaebol dominate the top end of the retail sectors as they dominate many other areas of South Korean business. The big four, Lotte, the largest group in retailing; Samsung, the largest chaebol in South Korea; Hyundai, which owns Keum Kang; and New Core, the most recently developed chaebol, hold a market share of over 80% in the department store sector (see Table 22) (South Korea, 1998). Many small and medium-sized merchants have recently condemned some big conglomerates for posing as assisting foreign firms by operating as many stores as possible while promoting joint ventures with foreigners without actually investing in securing competitive advantages (Cho, 1996).

Several South Korean conglomerates have agreed to suppress any hostile takeover bids in an effort to support economic stability and prevent domestic companies from falling into foreign hands. Samsung, Hyundai, and LG intervened to try to stop one of the country's first hostile takeover bids -an attempt by the Dongbang food group to acquire Midopa department stores. Midopa used the threat of foreign ownership to induce Samsung, Hyundai, and LG to buy bonds with equity warrants as part of a defensive move by its parent group Dainong in order to maintain its controlling stake in the department store chain ("Chaebols Act To," 1997).

South Korean conglomerates should be able to focus such keen attention on the retail business that, through large-scale retail activities, the conglomerates could gain access to huge amounts of cash flow, up to several billion won a day. Furthermore, retail businesses will enable

Table 22

South Korean Leading Retailers in 1997

Operator	Format	Facia
Lotte Group	Department stores Convenience stores Discount stores	Lotte Lotte L-Mart
Samsung Group	Department stores Warehouse clubs Discount stores	Shinsegae Price-Club E-Mart
Hyundai Group	Department stores	Hyundai
New Core Group	Discount stores	Kim's Club
LG Group	Department stores Convenience stores	LG LG25
Hwa Sung Industrial Co.	Department stores Supermarkets Discount stores	Dong-A Printemps Dong-A Supermarket Delta-club
Hanhwa Group	Department stores Variety stores Supermarkets	Hanhwa Hanhwa Hanhwa
Dianong Group	Department stores Supermarkets	Midopa Spar
Hanyang Store Co.	Supermarkets	
Taegu Department Stores	Department stores Supermarkets	Taegu Taegu

Note. Adapted from South Korea. (1998). Retail trade international, Volume 4 (pp.2081-2114). Chicago, IL: Euromonitor International Inc.

them to leverage their real estate investments by mortgaging their most valuable assets (“Daewoo’s Entry Into,” 1993).

Summary

The “chaebol,” or large conglomerates, have been a distinctive feature of South Korean industrial development. South Korea’s rapid development has been in large part based on the effects of the chaebol. This chapter has discussed the history and characteristics of the chaebol, and the chaebol’s effects on the South Korean economy. The South Korean government supported the chaebol, and the efforts of the chaebol enhanced the economy of the nation. It can be argued that, without the chaebol, the South Korean economic miracle would not have taken place. So pervasive have the influence and power of the chaebol become, that the government has no choice but to rely upon the chaebol for the funding and expertise to make the much needed transition to value-added production (Cho, 1993). In this respect, it seems that the increased concentration of economic power is a cost of growth (Burton, 1993).

CHAPTER VIX

CONCLUSION

Liberalization in South Korea has occurred because of the internal recognition of the benefits to the domestic economy of opening the market to greater foreign participation, and because of foreign pressure for market-opening. The rapid liberalization of South Korea's market has not been a smooth nor a coordinated process. An unstable economic and political situation has resulted, characterized by imbalances between imports and exports, a high cost of living, the traditional synergism between the South Korean government and the chaebol, the preferences and sometimes extravagant tastes of South Korean consumers, as well as the other factors discussed in this research. The factors impacting the South Korean market are closely interwoven and interactive, and a change in one factor produces changes in others. Therefore, prediction of future trends is difficult, but it is hoped that the identification and discussion of the factors involved will help to clarify the challenges currently facing the nation.

Many countries, in many different parts of the world, with very different economic systems and at different stages of development, have all headed in the same direction. There are, of course, different national circumstances that explain the detailed strategies and timing of countries' individual initiatives. The overarching force, however, has been the process of global competitive liberalization. The rapid increase of global interdependence has forced many countries, whatever their prior policies or philosophies, to liberalize their trade and usually their investment regimes.

Countries like South Korea, which have pursued export-led growth, find themselves facing a very different international economic landscape than in the past. South Korea has mostly traded with the advanced countries---the U. S., Japan, and the European Union (formerly European Community). This has often caused friction over trade imbalances. As South Korea has gradually increased its trade with developing countries, however, the share of its trade with advanced countries has gradually decreased. To the extent that the advanced countries remain key to trade and crucial as partners in industrial science and technology, South Korea will have to endeavor to minimize friction by opening its markets to the same degree as those of developed countries, starting with industrial goods and agricultural products and extending to the service market as well. It is clear that South Korea will continue to try to achieve expanded, balanced trade, and South Korea hopes to enjoy increased technology cooperation with the advanced nations ("Korea's International Economic," 1996).

South Korea has been making steady progress in opening its markets and globalizing. Domestically, the government has been rapidly increasing the import liberalization ratio, and externally it has been globalizing its domestic industry by investing overseas. The present government has realized that South Korea can no longer rely on foreign loans as it pursues a more sophisticated economic structure.

The cases of Taiwan, Thailand, Hong Kong, and other Southeast Asian countries which opened their distribution markets to foreign investors in the 1980s, have negative implications for South Korea. Taiwan opened its electronics market completely, followed by reductions in taxes on commodities and customs in 1986, 10 years earlier than South Korea. Ten years after Taiwan's market-opening, its retail and wholesale sectors as well as its electronics industry were seriously damaged by foreign influences. Many market experts forecast, however, that South Korea's situation will assume a different aspect from those of Taiwan and other Southeast Asian countries. The main reason is that South Korea's distribution and consumer goods manufacturing industries are far stronger and more stabilized than those of Taiwan and other Asian countries, because South Korea opened its market 10 years after they opened theirs. The South Korean government also shows its confidence in market-opening; as a spokesman said, "Korea's market liberalization was not decided in a single effort. We granted it eight years from July, 1988, and had made preparations for it step by step to reduce unfavorable side-effects (Sohn, 1996a, p. 25)." A spokesman for the Ministry of Finance and Economy (MFE) said, "In view of the results achieved so far, the partial opening of the distribution sector in 1994 has induced modernization in the structure of distribution, including a price-destroying boom" (Sohn, 1996a, p. 25).

The open market fosters new arrangements in currency transactions and in import opportunities. South Korea is unique among developing countries in the mix of state and open market systems that it uses to deliver goods. Models adopted by other countries may not necessarily work for South Korea. If South Korea can achieve its goals and achieve a measure of stability in a shifting global marketplace, the lessons for other developing nations will be both useful and applicable. The introduction of open market retailing has raised interesting possibilities for the accelerated development of the South Korean economy in general, and for retailing specifically. Open market retailing is changing the structure of South Korea's retail distribution and has a strong impact on the type and quality of goods available to South Koreans.

One factor that has implications for the South Korean economy is the chaebol Kia financial crisis, which started in July 1997. The effects of South Korea's financial crisis on the economy are still being felt. The Kia Group went bankrupt in 1997 after defaulting on 276.9 billion won worth of bills in mid-July. After its default, the interest rates and yields on three-year corporate bonds rose, and the Bank of Korea (BOK) had to provide emergency loans totaling 1.5 trillion won to Kia's creditor banks and affiliates. More damaging to South Korea's economy than the immediate effects on South Korea's financial market was that the Kia crisis exposed the nation's situation of bad credit and bad loans. This exposure has made some international credit rating agencies, such as Standard and Poor's, downgrade the credit ratings of both the country and its major banks, which only indicates more trouble for South Korean financial institutions when they look for overseas loans. Another problem for South Korea has been bad loans, amounting to 22 trillion won worth of loans extended to bankrupt and near-bankrupt companies (Korea International Trade Association, 1998).

Grounded Theory

This research began by collecting raw data from a variety of sources in order to establish a data base, and then triangulation was used to validate these data. As the research progressed, it became obvious that, in order to understand retailing in South Korea and the effects of market liberalization on South Korean retailing, it was necessary to investigate retailing in the larger context of the South Korean economy, due to the fact that retailing is an integral sector of that economy. It was discovered during the course of the research that the retailing of clothing and textiles in South Korea was a component of a larger picture of retailing in the South Korean economy, and that retailing itself was subject to both complex domestic and foreign economic influences. It was found that there were many interrelated factors that impact the South Korean economy in general, and retailing specifically.

One of the advantages of grounded theory is that it is particularly suitable for dealing with complex topics, in that the raw data are organized into categories, or themes, allowing the researcher to identify the important factors that have impact on the topic. In the case of this study, the themes that were discovered led to the research questions that guided the study. The following factors were identified and discussed in this study: the effects of foreign direct investment (FDI); the effects of the price-gap between imported goods and domestic products; the effects of South Korea's trade deficit; the effects of perceived over-consumption of luxury items by South Korean consumers; and the effects of chaebol, or South Korean large conglomerates. In addition to the above themes, two factors also were identified as being significant in their effects on the South Korean economy in general, and retailing specifically, and are discussed briefly in this chapter. They are: (1) parallel importation, and (2) international policies.

“Over-consumption” by South Korean Consumers

(1) What have been the effects of perceived over-consumption of luxury items by South Korean consumers on the South Korean economy, including the retailing industry?

The rapid growth of the South Korean economy, combined with the history of the Korean preference for imported goods, caused a trend of so-called over-consumption. One response to the worsening condition of the Korean economy was to launch a frugality campaign to discourage indiscriminate over-consumption of luxury items, many of which are foreign imports. This was met by negative reactions from the World Trade Organization and foreign investors. The frugality campaign has negative implications for future economic development in two respects. Politically, it highlights the priority accorded to short-term political interests, with little regard for the damage to credibility overseas, and it will have little impact on the trade deficit, as consumer goods constitute only 12% of imports ("Oxford Analytica Asia," 1997).

It could be said that the South Korean government itself boosted a consumption spree of the people; however, statistics show that South Koreans are not reckless spenders. South Korea has the third highest savings ratio (close to 30%) among OECD countries. Rather than irresponsible spending on imports by consumers, it seems that the excessive borrowing for expansion projects of the nation's corporate giants, the chaebol, led to the nation's problems by increasing South Korea's external debt to an unmanageable U. S. $200 billion (Overmoe, 1997). The prosperity of the nation in recent years was in part illusory, because it was based upon the unrestrained borrowing of the large corporations.

High prices have resulted from the growth-oriented policy of past decades, which promoted producers and suppliers at the expense of consumers' rights and interests. In 1996, when the nation was about to move into tenth place in gross national product and in trade, consumers were more or less being neglected. Increased income and consumers' desire for new products, variety, and foreign goods, combined with the entrance of foreign distributors and retail competition, should lead to new distribution systems and increased retail innovation (Credit Card Boost," 1996).

The Effects of Rapid Globalization

Foreign Direct Investment

(2) What have been the effects of foreign direct investment on the South Korean economy, including the South Korean retailing industry?

As the South Korean economy becomes more open and liberalized, the role of foreign investors is becoming critical. Although FDI can be expected to add vitality to the South Korean economy, the competition with locally produced goods and services causes market instability that affects most sectors, including retailing. It has been shown that the price gap between imports and locally made goods has been narrowing; however, quality considerations are causing the gap in non-price competition to widen. Imports to South Korea continue to increase, a situation that has the potential of damaging domestic industries, including textiles, other manufacturing, and retailing.

By opening up its markets to FDI, South Korea has sought to establish a developed and advanced industrial structure ("Foreign Direct Investment," 1996); however, imported foreign goods have penetrated almost every corner of the domestic markets and are inundating them. The situation reached a point where it could not be further tolerated without leading to national bankruptcy. This impending crisis led to frugality campaigns that received enthusiastic responses from the public who shared the same views and misgivings. Frugality campaigns were voluntary and spontaneous grass roots movements of the people. In retrospect, it is clear that such movements originated from a self-defensive, survival instinct of the people. In January 1997, the Seoul Education Office, the Citizens' Alliance for Economic Justice, and other civic organizations started campaigns for frugal living "out of fear that South Korea may follow the suit of other failed countries if the current extravagances and spending spree remain unchecked" (Kim, 1997, p. 12). As part of the government's market-opening program, it has continued to simplify investment procedures for foreigners while extending various financial and policy supports. One certain aspect of direct retailing is that foreign companies will be able to come up with even more competitive prices and domestic firms will have to find countermeasures ("Foreign Direct Investment," 1997b).

If the nation only imports, South Korean capital will flow out of the country. Conversely, South Korean firms can learn advanced technologies from studying imported goods. Using what they have learned from imports, they can improve production methods and make higher quality goods to sell in overseas markets and domestic markets. Thus, imports can be viewed as instructional aids rather than just drains on the economy. South Korea instituted the "buy Korean products" movement because the nation needed to reduce imports by a large margin (Lee, 1996a); however, this does not mean that South Koreans should buy only South Korean products, which are often more expensive than imported goods. It means South Koreans should buy Korean goods when they are as good and as reasonably priced as foreign goods.

Foreign governments are no longer content to allow South Korea to pursue past practices, particularly its restriction of foreign entry into its domestic market, and are more likely to respond with protectionist measures of their own should past practices continue. As South Korea moves away from export-led industrial policies to the related goals of globalization and liberalization, the challenge is to pace the rate of developments arising from them in ways that will maximize the benefits of globalization and minimize economic turmoil domestically. Although FDI can be expected to add vitality to the South Korean economy, the competition with locally produced goods and services causes market instability that affects most sectors and will require adjustments by domestic firms.

International Policies

An important area where economic policy seems unlikely to change is the progressive opening of the South Korean market. Virtually all industrial products are now exempt from import restrictions. Agricultural products remain heavily restricted, but in 1989 the government decided to liberalize many by 1991, and the target of 1997 for the removal of all remaining agricultural import barriers was realized (Pauley, 1990). South Korea has been making steady progress in opening its markets and globalizing. Domestically, the government has been increasing the import liberalization ratio, and externally it has been globalizing domestic industry by investing overseas.

The Organization for Economic Cooperation and Development: OECD.

In late March of 1995, South Korea formally filed an application to join the OECD as part of President Kim's new five-year economic plan for 1993-1997 ("What OECD Membership," 1996). On December 12th 1996, South Korea became the 29th member of the OECD, with the submission of an admission document to the French government (“Korea Becomes 29th," 1996). Korea signed the agreement to join the OECD 19 months later. Seoul has so far remained committed to economic liberalization and structural reforms as part of its globalization plan as a member of the OECD.

With OECD membership, Seoul will be able to diffuse foreign market-opening pressures. The United States has traditionally pressured South Korea into opening particular sectors, but other OECD members, including European countries, may check such unilateral pressure from a particular country. OECD membership is an occasion for westernizing the domestic system and practices, and should have the effect of inspiring competition. OECD entry and trade liberalization will eventually make access to imported goods easier. The United States and Europe have pushed South Korea to be more open in its bond market and cross-border capital flows. With the free flow of capital into South Korea, businesses that lack competitive advantage face the danger of being pushed out of the market. In the service sector, South Korea is likely to see increasing inroads by foreign distributors into both retail and wholesale services.

With market-opening taking place ahead of schedule, structural changes in the financial sector will soon become more and more apparent as banks and securities trading firms move in. The U. S. is expected to increase pressure on South Korea to further open its agricultural, service, and automobile markets in association with the scheduled bailout funds from the IMF starting at the end of 1997 ("U.S. to Hike," 1997).

The International Monetary Fund: IMF. It has been noted by officials at major conglomerates and their lobbying group, the Federation of Korean Industries, that after the IMF loan to South Korea fully materializes, the United States government is expected to push for the further opening of the South Korean market. Mr. Chung Hyun, senior researcher at the Federation's International Business Department, said that the IMF bailout loan may not necessarily lead to the immediate call for full market-opening, but is likely to boost foreigners' demand for wider opening of the corporate bond market. He also said that developed economies are likely to raise their calls for further opening of domestic markets after the national economy gains some strength through financial and industrial restructuring after the loan. One South Korean supporter of a market economy has said that industrial countries would particularly demand liberalization of those sectors which enjoy advantages and which have been viewed as too closed and complicated. He has said that their call for market-opening would become stronger than ever after the completion of a critical phase of restructuring. Services, automobile, and other high-tech industries as well as the agricultural sector have been cited as the major targets of the U. S. and other nations for additional liberalization (Chun, 1997).

At the second memorandum on the economic program agreed between the South Korean government and the IMF on December 24, 1997, the South Korean government promised implementation of more reformative measures at an accelerated pace than it did in the first memorandum of December 3, 1997. According to the program, South Korea will accelerate measures to open the economy to imports and eliminate trade-related subsidies in order to increase competition and efficiency in the domestic economy (see Table 16).

The General Agreement on Tariffs and Trade: GATT. After South Korea joined the GATT as a member in 1967, it pursued an export-oriented development strategy until the late 1970s. Before the end of the mid-1970s, South Korea did not adopt positive market opening policies due to the chronic deficit on the balance of payments. During the mid-1980s, the South Korean economy grew rapidly and the trade balance became positive. From this time, the nation began a program to open and internationalize the South Korean economy to improve domestic industrial competitiveness, to maintain harmonious trade relations with trading partners, and to play a role matching its position as one of the world's 12 major trading countries. In October, 1989, South Korea announced that remaining import restrictions would be gradually eliminated or brought into conformity with GATT provisions by July 1, 1997. In accordance with the 1989 consultations with the GATT Committee on the Balance of Payment Restrictions, South Korea notified GATT in March, 1991, of its pre-announced liberalization schedule (a total of 133 items) in 1992-1994 as the first-step notification. It gave its second step and final notification in April 1994 (a total of 150 items) ("Trade & Industry," 1996).

The World Trade Organization: WTO. The WTO is speeding up the integration of world trade as the main axis of the world trade order, promoting competition across borders and rapidly advancing the global economy. On the other hand, world trade has evolved with great complexity in its expansion and reinforcement of regionalism, in spite of the fact that multi-nationalism has strengthened since the beginning of the WTO. As the basic paradigm of the world trade order has changed from exclusive protection of national interests to trade relations, countries have fundamentally changed their policies. Every country cannot but cooperate in order to survive under the fierce competition, pursuing policy changes in consideration of the mutual dependency between countries. In particular, the end of the cold war is leading to fast advancement in technology, and the development of transportation, telecommunications, and information systems; however, the rapidity of globalization is impacting the degree of effectiveness of trade policies. Export-drive policy, aimed at accumulating national wealth through the protection of local industries, cannot contribute to maximizing competition under globalization.

The Trade Deficit

(3) What have been the effects of South Korea’s trade deficit on the South Korean economy, including the South Korean retailing industry?

By 1997, South Korea had not been able to improve its balance of trade to any significant degree, despite a rapid growth in exports. Initially, unilateral transfers financed the deficits, but more recently, the deficits have increased because of foreign borrowing. The opening of the South Korean market has fostered an increase in consumer purchasing of foreign imports. Another contributing factor to the trade deficit is increased dependence on foreign imports for equipment and machinery, including electronic equipment and steel. Economic projections for the future are not optimistic, and local consumers, manufacturers, and traders are discouraged.

South Korea's deficit in trade with the U.S. and other advanced nations has been widening at an accelerating pace. Previous economic slow-downs were accompanied by an improvement in the trade balance brought about by a decline in demand for imports; however, the current economic slow-down is accompanied by a deterioration of the trade balance that has registered a record deficit. The combination of a steep cut in the export price of semiconductors, rising imports of consumer goods, and dwindling exports of shoes, textiles, and leather goods resulted in the estimated U. S. $19 billion trade deficit in 1996 (Ahn, 1997).

The rapid growth of imports has meant that South Korea could not improve her trade balance significantly, despite the more rapid growth of exports from a much smaller base. Trade deficits increased somewhat in absolute level between 1965 and 1983, although there were many fluctuations in the interim years. The net balance on goods and services showed a similar trend during that period. The current accounts balance, which is equivalent to the net balance on goods and services plus net transfer receipts from abroad, also showed a deficit in most of the years (see Tables 23) (“Foreign Trade, Exchange,” 1998; Kim, 1991).

Table 23.
South Korean Exports and Imports from September 1995 - January 1998

Year	Exports	Imports	Trade Balance US$ million
	US$ million	US$ million	
‘95	125,058	135,119	-10,061
9	10,974	11,617	-643
10	11,524	11,732	-207
11	11,463	11,876	-414
12	11,757	11,806	-49
‘96	129,715	150,339	-20,624
1	9,923	12,047	-2,124
2	9,884	11,482	-1,599
3	11,689	12,135	-446
4	10,637	12,673	-2,036
5	11,236	12,679	-1,1443
6	11,302	11,728	-426
7	9,897	12,729	-2,832
8	9,887	12,958	-3,271
9	9,992	11,404	-1,412
10	11,848	13,544	-1,696
11	11,393	13,361	-1,962
12	12,220	13,598	-1,377
‘97	136,620	144,536	-8,010
1	9,034	12,616	-3,460
2	9,362	11,486	-2,122
3	11,327	13,059	-1,732
4	11,402	12,803	-1,401
5	11,747	12,272	-515
6	12,395	12,287	108
7	11,816	12,645	-829
8	11,058	11,501	-443
9	11,452	11,548	-96
10	12,512	12,595	-80
11	11,961	11,691	270
12	12,558	10,238	2320
‘98	9,164	7,563	1,601
1	9,164	7,563	1,601

Note: Adapted from Foreign Trade, Exchange Rate & Prices, by Korean Economic Trends, 1998.

South Korea began to accumulate its trade deficit at its market-opening in 1994 (Cheong, 1996), and the nation's current account balance has continued downward since then, accumulating a huge trade deficit of nearly U.S.$ 12 billion in the first half of 1996. In 1996, GDP growth fell to 6.8% from 9% in 1995. Most seriously, the current account deficit climbed 165% to U. S. $23.7 billion, the second largest in the world after the United States'. The deficit has resulted primarily from an unfavorable balance of trade. Imports from abroad have greatly increased since market-opening began (Cheong, 1996).

The primary reasons for the large trade deficit include, among others, the loss of export price competitiveness due to the weakness of the Japanese yen and the drop in prices should due stimulating exports. Further liberalization and wide opening of the distribution and commodity markets are acting to boost imports of consumer durable goods (Cheong, 1996). Imports to South Korea continue to increase, a situation that has the potential of damaging domestic industries, including textiles, other manufacturing, and retailing.

Chaebol

(4) What have been the effects of "chaebol," or large conglomerates, on the South Korean economy, including the South Korean retailing industry?

In the past, the chaebol have been crucial to South Korea's rapid economic development. Several factors have attributed to the rapid expansion of chaebol. These factors include government reliance on the experienced business skills and superior organization of the big chaebol, distorted factor markets (especially the credit market), the chance to achieve inflation profits, and a strong entrepreneurial ambition to build corporate empires (Lee, 1985). The influence and power of the chaebol are so widespread in South Korea that the government is compelled to rely upon the chaebol for the funding and expertise to make the much needed transition to value-added production (Cho, 1993). The South Korean government's reliance on and protection of the chaebol have boosted economic growth, but the concentration of economic power is a negative factor associated with growth (Burton, 1993).

The South Korean government and the chaebol have had a symbiotic relationship, but it has been at the expense of smaller industries and businesses. Initially, government policy relied on the development of large business groups in order to achieve economies of scale and realize competitive advantage in export markets. Increasingly, however, the competition from the chaebol has had a negative effect on smaller, less differentiated, and non-government-supported businesses.

Suggestions for Future Research

Statements have been made in the U. S. media, in its reports about the recent turmoil in South Korea's economy, that the South Koreans are "ungrateful" or are "trying to bite the hand that feeds them." These same newspapers and TV stations have also praised what had been achieved out of the devastation of the Korean War (Choi, 1998). It is obvious that, for South Korea, increasing globalization is unavoidable and brings risks as well as benefits. Previous research on the effects of globalization on the South Korean market, and the various sectors of the economy is lacking in both theoretical and empirical studies. It is difficult for research to keep pace with the rapidly changing economic climate; however, both theoretical and empirical studies can enhance one another and begin to build a body of knowledge. This body of knowledge can add to an understanding of the economies of developing countries and, specifically, can be enlightening about the intricate interplay of factors involved in the South Korean economy as the nation approaches the 21st century. Retailing in South Korea is a sector of the large South Korean economy, and to be able to understand the dynamics of South Korean retailing and the directions it is likely to take in the future, it is necessary to place it in the larger context of factors that impact the South Korean economy in general. Any one of the factors discussed in this research could be investigated in greater depth, and could be augmented with data derived from surveys, interviews, and the use of economic models. It is hoped that the identification and discussion of some of these factors, as presented in this study, can enhance an understanding of the challenges facing South Korea currently and in the future.

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