




FROM BEIJING TO BUDAPEST

Winning Brands, Winning Formats*

2005/2006

4th Edition

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PRICEWATERHOUSECOOPERS 



Korea (South)

Korea (South)

ECONOMIC OVERVIEW

GDP and CPI

South Korea's economy performed far below expectations in 2004, despite a spectacular 31% surge in exports. GDP growth slowed to an estimated 4.7%, falling beneath the government forecast and offering little consolation over 3.2% growth in 2003.

GDP and CPI

	2001	2002	2003	2004
GDP growth (%)	3.8	6.9	3.2	4.7
CPI (%)	4.1	2.8	3.5	3.6

Source: EIU, August 2005

Unemployment

Although the number of jobs increased in 2004 compared to the previous year, job insecurity has remained an acute problem as youth unemployment lingered and the number of non-regular workers continued rising. The youth unemployment rate (theoretically covering the age groups of 15-29) during this period was 7.8%, or two times higher than the rate of total unemployment.

Unemployment

	2001	2002	2003	2004
Unemployment rate (%)	4.0	3.3	3.6	3.7

Source: EIU, August 2005



Area ('000 sq km)¹: 99.26
(US 9,600 – EU25 3,981 – World 133,700)

Capital²: Seoul
(Number of inhabitants: 22 million)

Population (million)³: 48.2
(US 293 – EU25 456 – World 6,376)

GDP (USD billion)³: 680.7
(US 11,735 – EU25 12,723 – World 39,503.5)

GNI per capita (USD)¹: 12,030
(US 37,870 – EU25 22,810 – World 5,110)

Currency: South Korean Won (KRW)

Languages: Korean

Main religions: Christian, Buddhist

Government type: Republic

Sources: CIA Factbook; (1) World Bank 2005; (2) City Population; (3) Economist Intelligence Unit 2004 data

Economic forecasts

Due to the expectation of a decrease in exports and consumer spending, economic growth in 2005 is projected to decrease to 3.2% from 4.7% in 2004.

- The export growth rate is likely to decrease to 8.9% in 2005 from 30.7% in 2004, due to the impact of the global economic slowdown and a weaker IT sector prospect.
- The import growth rate is projected to rise by around 12.6% in 2005 due to a strong won against the US dollar, and the surging prices of oil and other raw materials.

Key economic forecasts

	2005	2006	2007
GDP growth (%)	3.2	4.3	4.6
CPI (%)	2.9	2.4	2.5
Unemployment rate (%)	3.1	2.9	2.7

Source: EIU, August 2005

REGULATORY ENVIRONMENT

Foreign direct investment

The Korean Government established the Foreign Investment Promotion Act (FIPA) to promote foreign investment in 1998:

- Tax incentives for foreign investment

Subject	Tax benefit
Foreign invested company	Reduction on corporate income tax; reduction on taxes relating to the acquisition and registration of assets; reduction on property tax; exemption from customs duty, special excise tax and VAT imposed on capital goods.
Foreign investor	Reduction of tax on corporate and individual dividend income
High technology provider	Tax exemption on corporate and individual income from high technology businesses
Foreign labour	Income tax exemption

- Foreign investment limited industries

Except as otherwise set by specific laws and the regulations of the Republic of Korea, foreigners may engage in, without restraint, various activities of foreign direct investment in the Republic of Korea. However, subject to restriction are foreign investment activities that: threaten national security and public order; have a harmful effect on public health or the preservation of the environment; are markedly contrary to commonly accepted

Korean standards of decency and morality; violate any Korean laws and regulations.

Business categories where foreign investment is restricted are as follows:

- Postal service, central bank, individual-business mutual aid, pension, stocks and futures exchange, other financial market management and clearing houses.
- Legislative, administrative, judiciary, foreign diplomatic missions to Korea, and other international and foreign organisations.
- Research and development of economics, or research and development in liberal arts and social science.
- Educational organisations (infant school, primary and secondary educational institutions, special educational institutions).

Other than the said industrial areas, foreign-invested companies can enjoy advantages such as low land costs, adequate power and water supplies, good road networks, tax incentives and various support facilities.

FDI

	2001	2002	2003	2004
FDI (KRW bn)	3,352	2,514	3,352	8,590
FDI (USD bn)	3.5	2.4	3.2	8.2

Source: EIU, August 2005 (Exchange rate: December 31, 2004)

Property/Real estate regulations

The regulations on land acquisition, use and development, applied to Korean nationals apply equally to foreigners. If a foreigner intends to acquire any land in Korea, in principle, the foreigner can purchase it regardless of the target land's zoning district. The foreigner only needs to report to the competent government office after the land acquisition. However, prior approval is required for acquisition of land in a military facility protection zone, cultural property protection zone, ecosystem conservation zone, or some islands that are used for military purposes. Meanwhile, a building site developer/supplier cannot undertake an enterprise independently but can take part in the business as one of the investors of a corporation by investing jointly with the central government, local government, the Korea Land Corporation or the Korea National Housing Corporation etc. In this case, the share of foreign investment should be less than 50% of the total investment.

Other regulations

Competition law

The Monopoly Regulation and Fair Trade Act encourages creative enterprising activities, consumer protection and balanced development of the national economy by preventing the abuse of market-dominating positions by enterprisers and the excessive concentration of economic power, and regulating undue collaborative acts and unfair trade practices.

Tax

The Korean Government supports foreign-invested companies operating in Foreign Investment Zones with tax reductions or exemptions and privileges such as construction costs and basic facility support and exemption of the traffic generation charge.

Details of the available tax benefits are as follows:

- Tax reduction and exemption for foreign investment companies or corporations
- Tax support for foreign investors' dividend
- Tax exemption on advanced foreign technology
- Tax support for foreign technicians
- Expansion of scope for tax exemption on foreign workers' overseas allowance

VAT

Customs duties, special excise tax and value added tax are exempted on any capital goods a foreign-invested company imports as international or domestic means of payment contributed by its foreign investors and on any capital goods a foreign investor imports as its contribution to capital.

Store openings

A foreigner may establish a domestic business presence through establishment of a local corporation or a sole proprietorship, to either of which the Foreign Investment Promotion Act (FIPA) is applicable, or through establishment of a branch or an office under the procedures as set forth in the Foreign Exchange Transactions Act (FETA). A foreign corporation, however, may not be registered as a domestic sole proprietorship.

Imports

The Korean Government's regulations require that all importers have a general licence, as well as a specific licence for all imported items. Applications for licences for import are approved by government agencies or by the relevant manufacturer's association after screening. Each specific licence covers only one transaction and is necessary in order to secure a letter of credit. Imports are classified into three groups, as shown in the table below.

Classification of imports

Approval items	Most commodities, unless included on a 'negative list', which is officially known as the Export and Import Notice, and published by the Ministry of Commerce, Industry and Energy (MOCIE).
Restricted items	Items that the government wishes to limit. These are reviewed on a case-by case basis.
Prohibited goods	Some domestically produced luxury items, and goods deemed harmful to public health and morals.

DEMOGRAPHICS AND CONSUMER BEHAVIOUR

Population

Population evolution

Population

	2001	2002	2003	2004
Population (m)	47.3	47.6	47.9	48.2
Population growth (%)	0.7	0.6	0.6	0.6

Source: EIU, August 2005

Population by age group

The proportion of older people in the population is rising.

Age profile

% of total population	1998	2003	2008 (f)
0 – 14 years	21.9	20.6	19.1
15 – 64 years	71.7	71.5	71.4
Over 65 years	6.4	7.9	9.5

Source: EIU, April 2004

Urbanisation of the population

About 48% of the population lives in Korea's six biggest cities; 11 million people live in Seoul (excluding the province of Kyonggi-Do), the capital and largest city. Since 1960, the population of Seoul has increased from 10% to represent almost 23% of the total Korean population.

Monthly average income, expenditure and savings per household

Monthly average (KRW '000)	2001	2002	2003	2004	2001 – 2004 (%)
Income	5,115	5,366	6,064	6,462	24.4
Expenditure	3,221	3,263	3,700	3,855	19.7
Savings	1,894	2,103	2,364	2,607	37.6

Source: National Statistical Office

Savings continuously increased from 2001 as income increased. Although the government encouraged spending with a low interest policy, peoples' saving trend continuously increased due to their uncertain future expectation.

Urban/Rural split

% of total population	1998	2003	2008 (f)
Urban	80.4	83.5	86.3
Rural	19.6	16.5	13.7

Source: EIU, April 2004

Income/Buying power

The vast purchasing power and highly sophisticated taste of Korea's huge consumer base offers enormous advantages to investors. With 14 million passenger vehicles on the roads and 35 million mobile phone subscribers, the buying power of its 48.2 million population falls in the top range of Asian markets. This ability is highlighted by Korea's status as the world's twelfth largest importer in 2003. The corollary is demand for a range of products, from computers, other electronic goods and apparel to daily necessities, is among the strongest in the world.

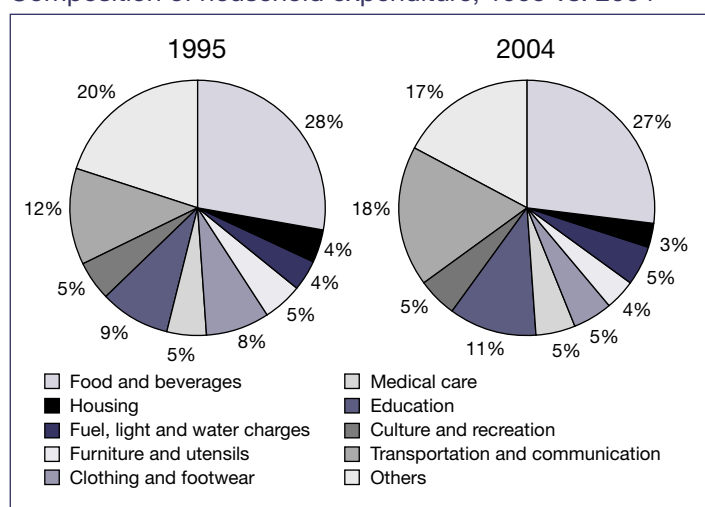
The enormous consumer base hungry for novel product ideas makes the country the perfect test market for innovative technologies and new products. In particular, the tendency toward early adoption among younger consumers, who are far more responsive toward the latest trends than those in other countries, has been the driving force behind the growth of the Korean electronic industry.

Consumer behaviour

Average household spending patterns

While the expenditure/income rate remained relatively stable between 1995 and 2004 (59.3% and 60.6%), spending patterns have changed slightly.

Composition of household expenditure, 1995 vs. 2004



Source: National Statistical Office

As Korea has become one of the most developed countries in the communication and mobile sector (for example, more than 75% of the population have a cell phone), expenditure in the communication sector is increasing. Moreover, development of transportation and increase of leisure time affected the transportation expenditures.

For the clothing and footwear sector, the market is already saturated, so no significant increase could be made.

Lifestyles/Shopping habits

Recently, many domestic consumers seem to spend along the particular line of lifestyle, influenced by others' hobby and leisure life. Accordingly, copycat or herd consumption behaviours are more common, resulting in a relatively shorter time for specific products to be fully popularised in the market. Moreover, the development of the media and influence of advertising have shortened the time span even further. Another example of herd consumption pattern is the formation of a group by one's consumption behaviour. For example, in the "luxury race", a small number of people try to differentiate themselves from other groups by purchasing luxury goods, most of which are brand-name imports such as Gucci and Chanel.

Self-centred consumption behaviour following trends in the market has also emerged. As many single workers in their 20s or 30s with professional jobs and relatively strong purchasing power have increased, combined with the emergence of the desire of self-satisfaction regardless of cost, products and services specially designed for individual tastes have come to the market.

Brand/Price sensitivity

Given the disparity in incomes, a degree of polarisation is reflected in consumer spending patterns. While low-price shopping outlets such as Dongdaemoon and Namdaemoon markets and other discount stores are on the increase, shopping places offering higher-priced goods and luxurious brands are also on the increase. For department stores, one of the strategies for surviving the recent depression is to try to divide the existing luxury market into old luxury (super premium) and new luxury (mass prestige). By strengthening the distinction in relation to discount stores, department stores are trying to regain discount store shoppers.

RETAIL & CONSUMER SECTOR PERFORMANCE

Major consumer goods players

Food & beverages

Key food retailers

Company	Category of products	Sales* (KRW bn)		2003-04 growth (%)
		2003	2004	
Cheiljedang	Food	1,724	1,847	7.1
Nongshim	Foods	1,522	1,645	8.1
Lotte Chilsung Beverage	Beverages	1,109	1,162	4.8
Lotte Confectionery	Foods	1,098	1,109	1.0
Daesang	Foods	883	1,002	13.5
Ottogi	Foods	803	879	9.5
The Hite	Beverages	822	861	4.7
Namyang Dairy Products	Foods	756	773	2.2
Maeil Dairy Industry	Foods	679	677	-0.3
Lotte Ham & Milk	Foods	623	651	4.5

(*) The sales stated in above table are related to food and beverages only.
Source: Companies' annual reports

Electronics

Key household electronic retailers

Company	Net sales* (KRW bn)					
	2003			2004		
	Domestic sales	Export sales	Total	Domestic sales	Export sales	Total
LG Electronics	1,946	3,703	5,649	1,982	4,234	6,216
Samsung Electronics	1,509	1,897	3,406	1,557	1,702	3,259

Source: Companies' annual reports

(*) The sales stated above relate only to household electric appliances such as refrigerators, washing machines, microwave ovens and air conditioning systems. Sales related to non-household electric appliances such as RAM (Random Access Memory), TFT-LCD (Thin Film Transistor Liquid Crystal Display), computers, mobile phones etc, are excluded.

Clothing

Key clothing retailers

Company	Sales (KRW bn)		2003-04 growth (%)
	2003	2004	
Kumkang Shoe	431	397	-7.9
Shinwon	382	367	-3.9
Tae Kwang	375	388	3.5
FnC Kolon	291	322	10.7
Changsin	259	303	17.0

Source: Companies' annual reports

Cosmetics and daily necessities

Key cosmetics retailers

Ranking	Company	Category of products	Category of products (KRW bn)		2003-04 Growth (%)
			2003	2004	
1	Pacific	Cosmetics, daily necessities	1,120	1,105	-1.3
2	LG Household & Health Care	Cosmetics, daily necessities	1,057	953	-9.8
3	Aekyung Industrial	Cosmetics, daily necessities	261	274	5
4	Coreana Cosmetics	Cosmetics	172	151	-12.2
5	Hankook Cosmetics	Cosmetics	86	69	-19.8
6	Hanbul Cosmetics	Cosmetics	100	63	-37

Source: Companies' annual reports

Major Retail Players

Retail sales

Total retail sales growth

	2002	2003
Total sales (KRW bn)	116,423	106,752
Growth rate (%)	26	-8.3

Source: National Statistical Office

Breakdown by number of stores

	Hypermarkets	Supermarkets	Discount stores	Convenience stores
2004	96	N/A	275	8,247
2003	85	6,708	265	8,584

Source: National Statistical Office

Retail channels

	Sales index (*)				
	2000	2001	2002	2003	2004
Department store	100	105.4	110.1	103.4	95.1
Discount store/ Hypermarket	100	126.8	153.8	167.1	176.8
Supermarket	100	96.7	95.8	96.6	89.8
Convenience store	100	142.6	195.8	239.2	247.6

Source: National Statistical Office, Ministry of Commerce, Industry and Energy of the Republic of Korea.

(*) Sales index in 2000 is 100.

Key retailers by scope of formats

Company	Store brands	Number of stores (2004)	Retail formats	2003 sales (KRW bn, excl. VAT)	2004 sales (KRW bn, excl. VAT)	2003-04 growth (%)
Lotte Group	Lotte Department Store	22	Department store	3,893	7,821**	N/A
	Lotte Mart	36	Discount store			
	7-Eleven	1,179	Convenience			
Shinsegae Co Ltd	Shinsegae Department Store	6	Department store	5,804	6,512	12.2
	E-Mart	99	Discount store			
Hyundai Group	Hyundai Department Store	7 (Including 2 outlets)	Department store	1,694	1,481	-12.5
	Hyundai Shopping	1	Department store			
	Hanmu Shopping	2	Department store			
	Hyundai DSF	2	Department store			
	Hyundai Home Shopping	-	Cable TV home shopping			
GS Group*	GS Supermarket	73	Supermarket	2,637	2,714	3
	GS Department Store	3	Department store			
	GS 25	1,850	Convenience store			
	GS Mart	11	Discount store			
	GS Home Shopping	-	Cable TV home shopping			
Samsung Tesco Co	Home Plus	31	Discount store	2,575	3,036	17.9
Hanhwa Stores Co	Galleria Department Store	7	Department store	571	305	-46.6
	Hanhwa Mart/Store	N/A	Supermarket, discount store			

Company	Store brands	Number of stores (2004)	Retail formats	2003 sales (KRW bn, excl. VAT)	2004 sales (KRW bn, excl. VAT)	2003-04 growth (%)
Carrefour Korea	Carrefour	27	Discount store	1,407	1,519	8.0
New Core Co	New Core Department Store	8	Department store	482	408	-15.4
	Outlet	5	Outlet			
	Kim's Club	21	Discount store			
The National Agricultural Cooperative Federation	Hanaro Club	26	Discount store, supermarket	1,200	1,232	2.7
CJ Home Shopping	CJ Home Shopping	-	Home shopping	400	412	3.0

Source: Companies' annual reports

(*) The company name of LG Mart changed to GS Retail in April 2004.

(**) Lotte has changed its recognition method of the sales from net sales recognition to gross sales recognition, while the others recognise the sales in net amount.

Food retail channels

Hypermarkets/Discount stores

Company	Store brands	Number of stores	2003 sales (KRW bn)	2004 sales (KRW bn)	2003 - 04 growth (%)
Shinsegae	E-Mart	99	5,125	5,832	13.8
Samsung Tesco	Home Plus	31	2,575	3,036	17.9
Lotte Shopping	Lotte Mart	36	1,494	2,329*	N/A
Carrefour Korea	Carrefour	27	1,407	1,519	8.0
The National Agricultural Cooperative Federation	Hanaro Club	26	1,200	1,232	2.7
Wal-Mart Korea	Wal-Mart	16	795	776	-2.4

Source: Companies' annual reports

(*) Lotte has changed its recognition method of the sales from net sales recognition to gross sales recognition, while the others recognise the sales in net amount.

Supermarkets

Company	Store brands	Number of stores	2003 sales (KRW bn)	2004 sales (KRW bn)	2003-04 growth (%)
GS Retail	GS Supermarket	73	591	576	-2.5
Haitai Stores	Haitai Supermarket	33	174	157	-9.8

Source: Companies' annual reports

Convenience stores

Company	Store brands	Number of stores	2003 sales (KRW bn)	2004 sales (KRW bn)	2003-04 growth (%)
Korea Seven	7-Eleven	1,179	580	490	-15.5
Bokwang Family Mart	Family Mart	2,700	790	1,019	29.0
GS Retail*	GS 25	1,850	768	911	18.6

Source: Companies' annual reports

(*)The company name of LG Mart changed to GS Retail in April 2004.

Non-food retail channels

Department stores

Company	Store brands	Number of stores (2004)	2003 sales (KRW bn)	2004 sales (KRW bn)	2003-04 growth (%)
Lotte Shopping	Lotte Department Store	22	1,819	4,895*	N/A
Hyundai Group	Hyundai Department Store	12	1,098	886	-19.3
Shinsegae	Shinsegae Department Store	6	679	680	0.1

Source: Companies' annual reports

(*) Lotte has changed its recognition method of the sales from net sales recognition to gross sales recognition, while the others recognise the sales in net amount.

E-commerce

Company	Store brands	2003 sales (KRW bn)	2004 sales (KRW bn)	2003-04 growth (%)
GS Home Shopping*	GS Home Shopping	539	505	-6.3
CJ home Shopping	CJ home Shopping	400	412	3.0
Hyundai Home Shopping	Hyundai Home Shopping	194	200	3.1

Source: Companies' annual reports

(*)The company name of LG Mart changed to GS Retail in April 2004.

The number of internet users in Korea more than doubled between 1999 and 2004, reaching 31.6 million in 2004. Internet sales reached a total of KRW6,443 billion during 2004.

Changing number of internet users in Korea

	2001	2002	2003	2004
Users ('000)	24,380	26,270	29,220	31,580

Source: Korea Network Information Center

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

Challenges

Rising competition

Rising competition in the retail market is one of the challenges faced by most retail companies in Korea. Conglomerates or chaebuls are also getting deeper into the business, establishing new hypermarket stores and discount stores all over the country. Retail stores with poor brand recognition and supported by little capital are increasingly suffering as a result.

Variability on customers' needs

Consumers' needs are more varied nowadays. Korean customers think that consumption is not only a mean to satisfy, but also to express themselves. As a result, retail companies have to react to the diversified customer's need.

Opportunities

Mass customisation

In response to the coexistence of herd consumption and individually unique consumption patterns, companies may let customers become involved in the development process of a product or service in order to address individual needs, nevertheless to appeal to a wide spectrum of people. Through such an approach, consumers can get differentiated, low-cost products with their input, and companies earn more money by selling such unique products.

Bringing hybrid high-touch into the business

In a response to the coexistence of nomadic tendencies and the settlement phenomenon, companies need to focus on both high-tech products and high-touch products. Companies have to be reminded constantly that many consumers purchase new products for more comfort and consolidation of functions.

High-value marketing

In response to the coexistence of smart consumption and emotional consumption patterns, companies need to develop high-value products, and at the same time enhance the quality of brand, design and corporate image to fulfil consumers' rational and emotional needs.

Emerging trends

Emotional consumption

Korean consumers are becoming more sophisticated and thus consider emotional and aesthetic factors like brand, design and corporate image, as well as basic factors like price and quality. Furthermore, they seek emotional satisfaction and fun from the shopping experience itself. Shopping has now become a hobby or leisure activity, especially among consumers in their 20s and 30s who have enough income to spend on themselves.

Many Koreans consider their consumption pattern as an efficient tool for expressing their own lifestyle, profession and income level. As a result, the symbolic meaning of consumption has become visible in the market. For example, the trend to consider the purchase of high-priced products as a standard to measure social status has spread to in the lower-class income bracket and to the younger generation. As a result, the sales of high-priced fashion items and beauty accessories have increased by 50% from year 2001 to 2003, and the total market size reached about KRW4 trillion in 2002.

Self consumption

The increasing number of single workers in their 20s or 30s with professional jobs and relatively strong purchasing power, combined with the emergence of the desire of self-satisfaction regardless of cost, products and services specially designed for individual tastes have come to the market, such as products of "Olivier," a luxurious hair accessories brands and high-priced spa, aesthetic and massage services. The younger generation, in particular, tends to express individual character and pursue "individual" products.

Smart consumption

Korean consumers are getting smarter in their consumption. When domestic consumers spend money, they actively gather information and utilise various channels, including the internet, to compare product prices.

Consumers, through internet sites, are now taking advantage of opportunities to purchase goods offering quantity discounts and time saving. Additionally, they fully utilise the various benefits provided by companies such as promotional discounts. For example, purchasing patterns now frequently reflect the promotional discounts provided by credit card companies for those that buy using their cards.

Another trend of smart consumption is the practical consumption patterns in the market, such as consumers' focusing on the appropriate usage of products rather than the prestige of possessing them. As a result, the rental business that enables consumers to borrow necessary items at a cheaper cost is a growth industry and the product range has become broader to include home electronic appliances, automobiles and even artistic works. Indeed, these renting options seem to make sense for products that need constant maintenance and special care like water purifiers or products whose time span is relatively short compared to other products such as video games.