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Discovering business opportunities in South Korea

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South Korea has been known as a rapidly growing prosperous economy, home to global conglomerates called chaebols. However, actual opportunities and challenges of the South Korean market remain unknown to most foreign companies. Here we discuss recent developments in the South Korean economy, and what they mean in terms of opportunities for market entry.

South Korea is actively searching for new paths to a more prosperous future, as it is increasingly challenged by other Asian countries. Southeast Asian countries are on the rise, and at the same time, Koreans have learned the hard way that China is not always easy to deal with. The trade disputes between US-China and Korea-Japan have also placed the South Korean economy under additional pressure, especially taken into account its high reliance on exports. Increasingly, companies—even mid-sized ones—in South Korea are seeking growth by reaching out to new markets. However, Korean companies are also looking for new forms of partnerships and collaboration. At the same time, the local market is developing. Understanding the South Korean economy, its opportunities and future direction is thus a very timely subject.

A democracy characterized by a coordinated drive for growth—a system that needs to reinvent itself

South Korea has been one of the fastest-growing economies in the world since the 1950s. It possesses a significant domestic market with a population of 50 million and is close to the bigger Asian markets of China and Japan. As opposed to China, South Korea is a developed democracy that offers a less risky business environment for those looking to enter the Asian market. On the other hand, the country is more dynamic than Japan and has a more

entrepreneurial, agile, and aggressive corporate culture.

The South Korean system of democracy operates under something akin to a bipartisan system, which has recently gone through many changes. The recent forceful, albeit democratic, change of presidency has had a big effect on the political landscape. The presidency still carries a lot of power, but from the fall of President Park Geun-hye, the country has learned that excessive executive power is not always a good thing. In addition, President Lee Myung-bak, who preceded Park Geun-hye, has also been undergoing investigations for bribery charges and other fiscal irregularities. At the same time, these trials involving former presidents have pulled several *chaebol* executives into the whirlwind as well. In addition, the political landscape is being shaken by a strong #MeToo movement, exposing the blatant sexual abuse of women.

In the past, the nation gave the impression of being steered from the top down in an efficient way that an outsider could easily deem as post-militaristic. When president Lee was elected in 2008, like his predecessors, he set an ambitious five-year vision for the country. The plan of President Lee Myung-bak was known as 747: 7% annual growth, 40 000USD GDP per capita, and elevating South Korea to the 7th largest economy in the world. He also set *Green Growth* as the new national development paradigm with the aim of turning the nation into a global leader in green technology. Unfortunately, this plan failed, and so did the attempts to make a strong five-year vision of his successor, President Park Geun-hye. The Park Geun-hye era of "creative economy" still prevails in a sense, but it is fair to say that the nation is still looking for ways to step back up to the kind of growth it has seen earlier during its industrial phase.

The chaebols, large family controlled Korean conglomerates, have in the past supported the execution of the national vision by setting their own growth targets accordingly. For example, following President Lee, Samsung announced an ambition to be the number one player in solar energy by 2015 and invested $20 billion in developing solar cells, rechargeable cells for hybrid electric cars, and LED technology; Daewoo built the world’s largest tidal power plants along the South Korean coastline, and Hyundai is invested heavily in solar and wind power around the world. However, as the weakness of centrally set plans has become increasingly evident, chaebols are now seeking their own path for growth. Increasingly this also means that their growth is driven by investments outside South Korea. The collaboration between the political powers and chaebols remains strong, although it is clearly on the decline due to recent events and efforts of the new Moon Jae-in administration. At the same time, the ability of the government to exert pressure on these large conglomerates is clearly weaker. The fall of President Park Geun-hye also demonstrated the dangers of collaborating too closely, leading to Samsung heir Lee Jae-yong’s conviction for bribing Park. His recent release shows that chaebols still have forces to be reckoned, but most certainly top management will thread more cautiously going forward.

Sustaining hypergrowth culture while facing challenging situations

South Korea is not a low-cost labor country, especially if compared to countries such as China, Vietnam, or Thailand. Although wages are still low outside the large cities, and for low

skill jobs in general, higher-level jobs have salaries comparable to Western standards. For companies considering South Korea as a potential base, the main benefits lie in its ambitious and educated workforce and strong working culture, rather than just labor cost arbitrage. Foreign companies should be aware that they may be at a cost disadvantage compared to local companies, and that labor regulations at times may hit them harder than domestic players (especially as they are usually not as used to handling labor relations as domestic companies are). The case of GM Korea attempting to leave South Korea illustrates the difficulties involved [1] [2].

Koreans possess a remarkably ambitious mindset. Having a high-reaching long-term target is of great importance in Korean culture, reflected not only in national and corporate target setting but also on all levels of society. Koreans are incredibly proud of last several decades of remarkable economic growth and establishing cultural presence in global stage, after overcoming various obstacles and suffering injustices as a country. This widely shared sentiment has historically reinforced nationwide efforts in pursuing greatness. This culture of ambition is visible everywhere: in working culture, education, as well as everyday life. It comes as no surprise that Koreans work more hours per capita than in any other OECD nation.

Furthermore, according to OECD statistics, Koreans have one of the highest levels of education in the world. Most of domestic income is typically spent on ensuring the best possible education for the children. Ambition is also visible in educational institutions. Many top Korean universities communicate bold visions, such as becoming one of the top universities in global rankings or having graduates continuing their studies in Ivy League universities. Korean universities also actively pursue exchange programs with foreign universities, ensuring knowledge transfer.

Great investments in education and an ambitious, hard-working population have been vital in the country’s growth. South Korea’s real GDP grew from 2.7 billion USD in the 1960s to over one trillion USD in the 2000s. Unlike Finland, South Korea only suffered a minor dip in 2008-2010 and has since resumed its previous growth path albeit at a somewhat lower rate.

More recently due to COVID-19, negative GDP growth was expected and reported. However, South Korea managed to keep the GDP drop smaller compared to other countries by quickly implementing measures to control the spread of infection while avoiding severe lockdowns (figure 2). Compared to the OECD average growth rate of -2.9% in 2020, South Korea reported significantly less-impacted growth rate of -0.8% in the same year [29].

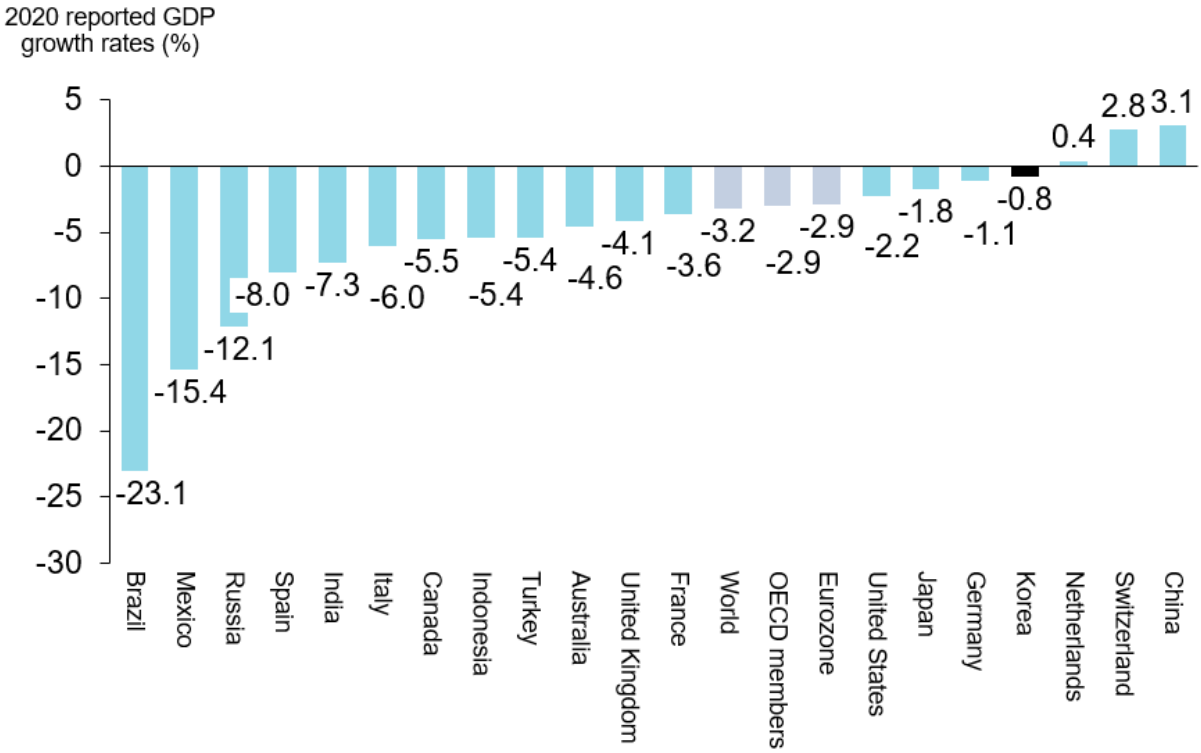


Figure 1. 2020 GDP growths reported by top 20 major economies [29].

South Korea has also faced challenges with its exports, partially due to the global economy and trade wars between China and the United States as well as Korea and Japan. The current situation is somewhat precarious; exports are challenged by a trade dispute between China and the United States especially in Korea due to high reliance on these two countries. China and the United States are the top export destinations and take 24% and 15%, respectively, of its total exports (figure 3). Meanwhile, the Korea-Japan trade dispute has challenged the Korean economy further. In particular, the technology industry has suffered as most chemicals needed for chips and display panel production are supplied from Japan. As a result, major Korean tech companies such as Samsung Electronics and SK Hynix have started accelerating localization of the supply chain, seeking to reduce their dependency on Japanese suppliers [3]. In addition to exports, there have been some concerns over household debt that it reached all-time high of 95.5% of GDP in 2019, which would lead to weaker consumption growth (figure 4).

Meanwhile, SMEs continue to be marginalized, suffering from low productivity and weak capabilities in R&D and international expansion (figure 5), partly driven by many of them being in a subservient relationship to chaebols, or simply being too small and ineffective. Given their low productivity and high contribution to employment in Korea, relatively speaking, this is one of the largest factors holding Korea back. For the economy to drive value creation and better standard of living for the many, it would be critical to improve the SMEs' position in the economy. A part of this is to help SMEs to become globally competitive and independent of "chaebol servitude", and another to reduce the amount of "forced entrepreneurship". Moving onto a virtuous cycle from a vicious cycle of this OEM trap can be realized by providing SMEs with global-minded management capability, competitive talent

pool, and network and insights in the international market (read more at Reddal Insight–SMEs and national economic development).

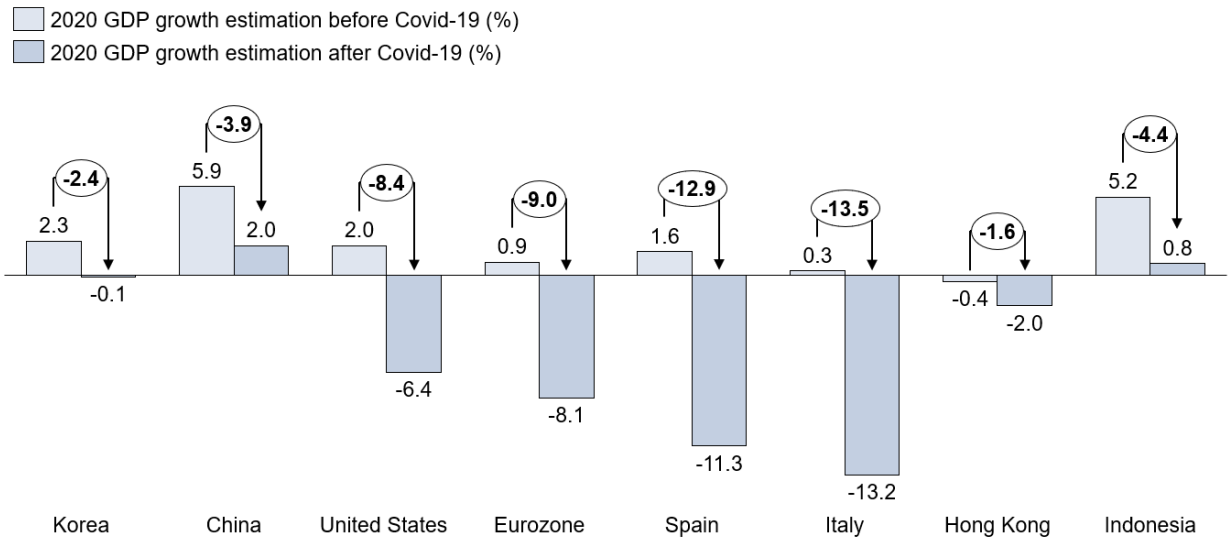


Figure 2. 2020 GDP growth outlook after COVID-19 (%) [4].

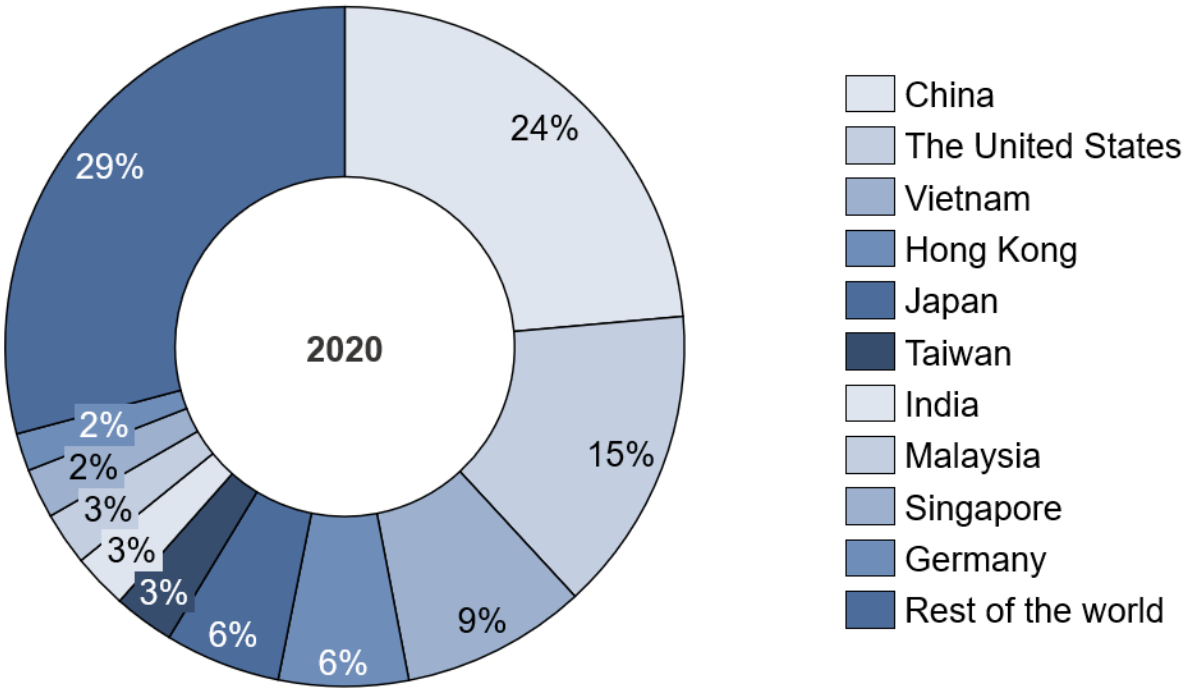


Figure 3. Export destinations from Korea (2020) [5].

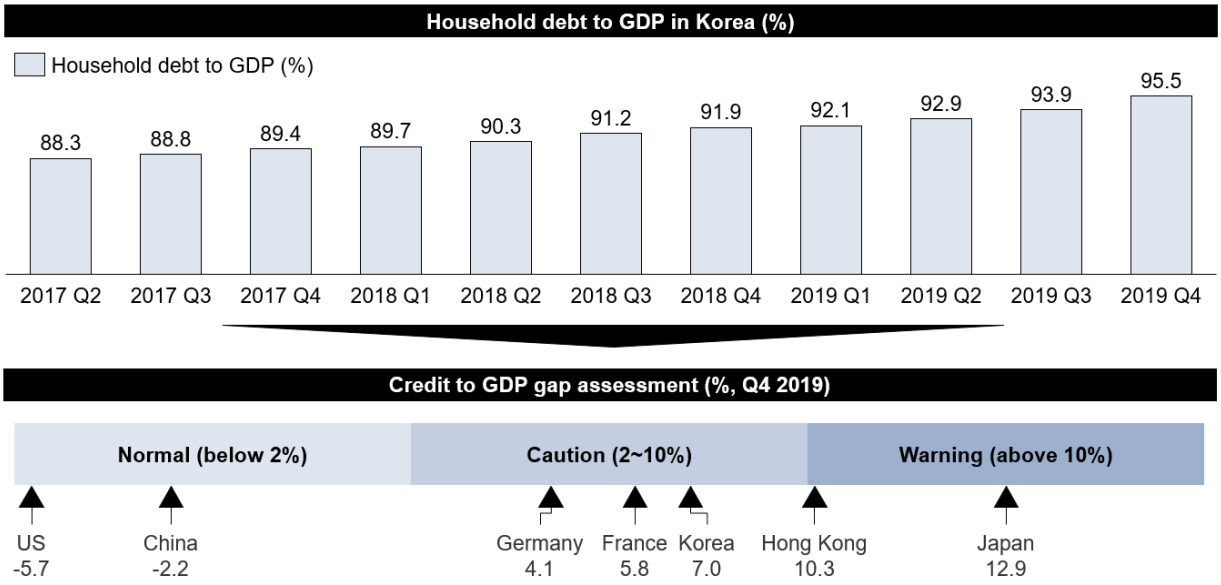


Figure 4. Household debt in Korea and credit to GDP gap assessment [6] [7].

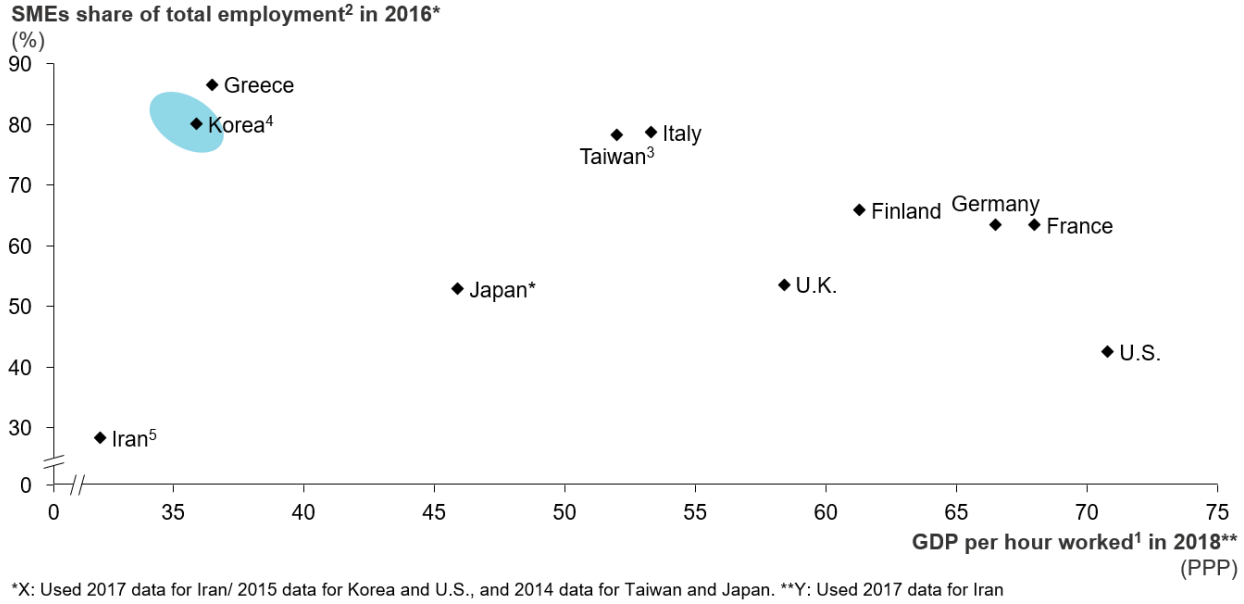


Figure 5. SMEs contribution to overall economy by country vs. SME productivity [8] [9] [10] [11] [12] [13] [14].

Korea Development Institute (KDI), a government think tank, has expressed concerns on the recent minimum wage hike. If the government continues its plan to raise the minimum wage by 15% every year, it could hinder employment in South Korea and may lead to an excessive amount of employment stabilization funds (figure 6). In fact, France had to stop raising the minimum wage once the minimum wage reached 60% of median earnings, due to negative effects on the unemployment rate; Korea's minimum wage relative to median wages is already high at 59% in 2018 (figure 7). Meanwhile, Korea managed to lower the youth unemployment rate to 8.9% in 2019, although it was mainly driven by short-term temporary employment; the number of temporary employees increased by 13% in 2019 compared to the previous year, whereas the number of permanent employees decreased by 3% (figure 8).

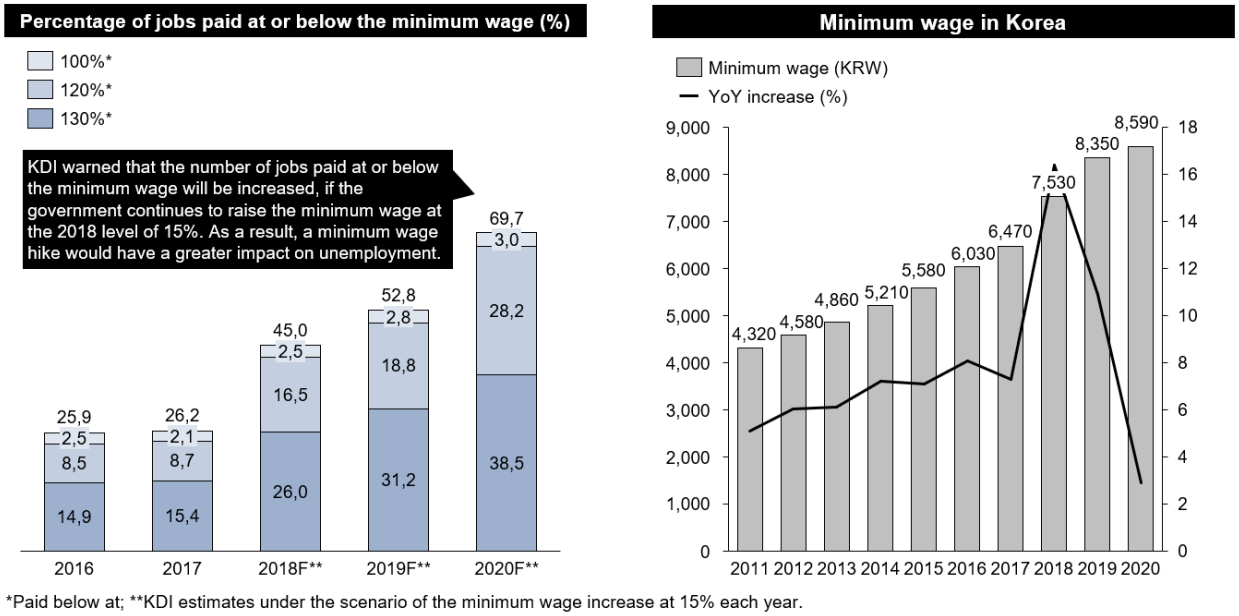


Figure 6. Minimum wage hike in Korea [15] [16].



Figure 7. Minimum wage relative to median wage [17].

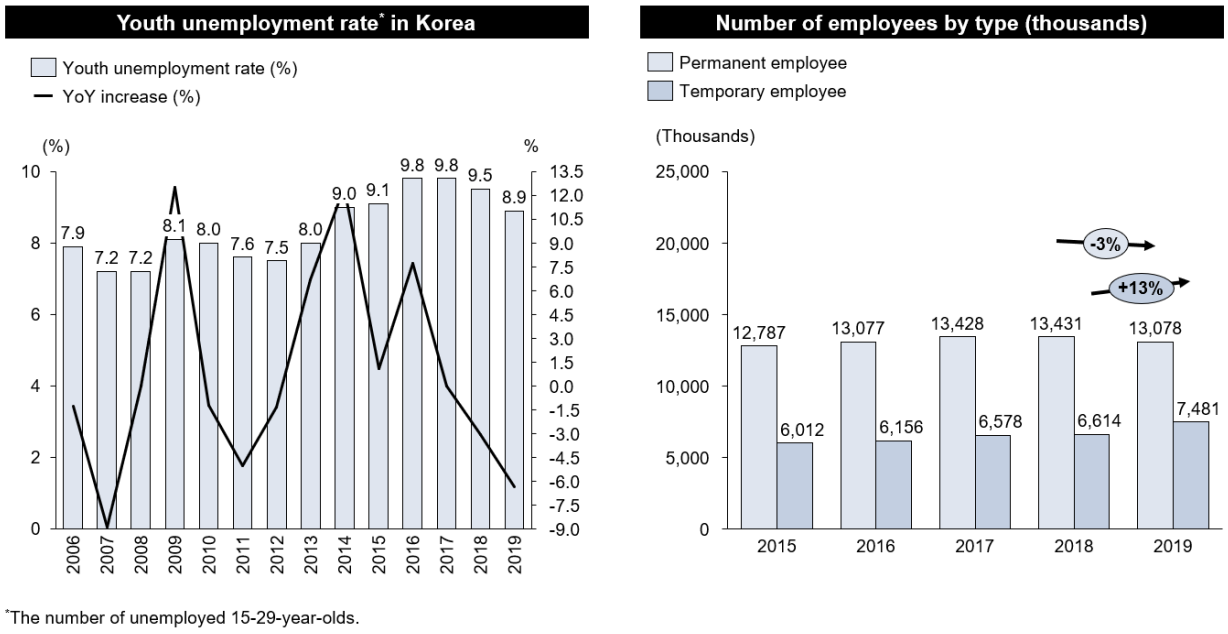


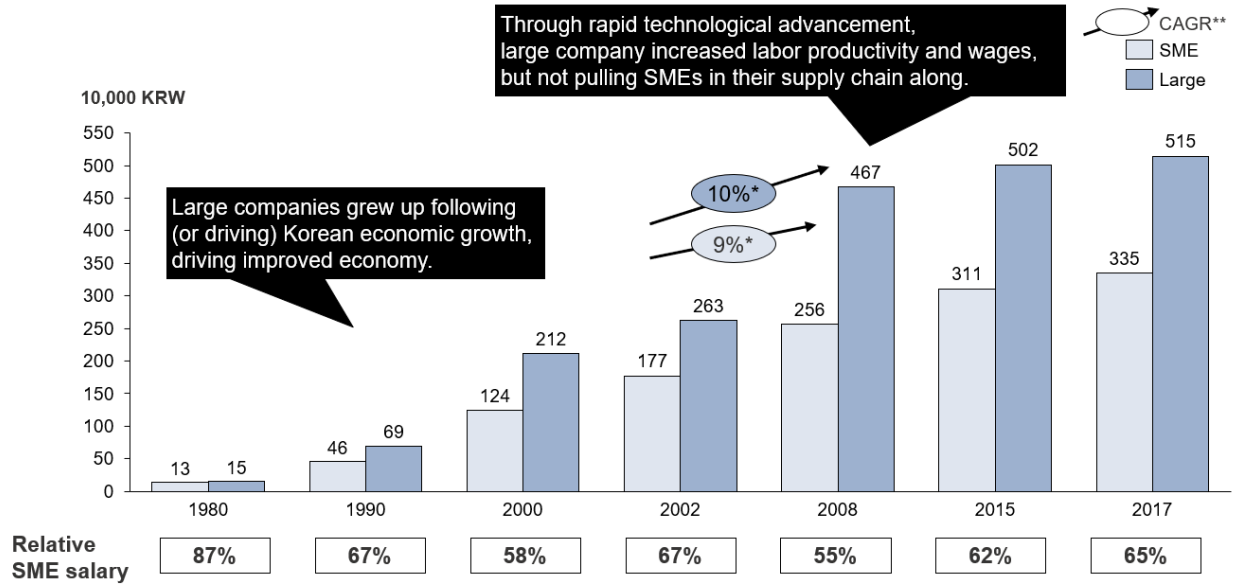
Figure 8. Youth unemployment in Korea [18] [19].

In 2022, global supply chain crisis caused by Russia's war in Ukraine has led to severe inflation worldwide. While Korea suffered increased inflation rate of 4.1% in March 2022, it is still below the OECD average of 8.8% [28]. This suggests Korea's past experience of trade disputes with neighboring countries may have strengthened domestic industry which is more immune to external crises.

Chaebols, culture, and language creating high barriers of entry

The large chaebols contribute to most of the GDP growth of the country. They continue to be tightly linked to the government, partly owing to the country's history. This, coupled with the fact that the conglomerates compete fiercely both among themselves as well as with any foreign entrants, has made it difficult for big foreign companies to enter the South Korean market. As an example, Nokia failed in its Korean market entry efforts due to government intervention and competition from LG Electronics and Samsung, according to a 2003 study conducted at the University of Tennessee.

Another challenge for foreign companies lies in attracting the best people. Most Koreans still see the large chaebols as the most attractive employers. Among Korean university graduates, chaebols are considered the most respected places to work, offering high wages and a lifelong career path. In Korean culture, respect of authority, seniority, and dedication to one's job is central. Although perceptions are slowly changing, especially among youth, many employees are still seeking to pursue long careers in the same organization. The employees of the chaebols execute corporate vision by aligning their own ambitious targets with those of the company. A new entry-level recruit at a major chaebol spends the first workweeks planning their own vision for their career development. The new employee is then assigned a mentor whom they meet monthly to revisit their career progress vis-à-vis the set-out goals. Salaries for lower ranks are relatively low but become substantial as senior levels are reached. The same applies to SMEs, although their salary levels are clearly below that of chaebols (figure 9).



*CAGR 1980-2017. During 1980-2000, conglomerate CAGR was 14% vs. SMEs 12%; during 2000-2017 conglomerate CAGR was 5,4% vs. SMEs 6,0%.
**CAGR = compounded annual growth rate.

Figure 9. Monthly salary comparison between SMEs and conglomerate employees [20] [21] [22] [23] [24].

Operating in South Korea can also be a challenge due to the country's business culture. The widely encountered sense of nationalism extends beyond job selection. A foreign company may have trouble finding clients; South Korean major corporations often prefer local production and Korean suppliers. For a country dominated by several global conglomerates, the business environment has surprisingly little cultural diversity. Knowledge of the Korean language is a requirement for a foreign market entrant as Korean is still the main business language. Furthermore, the society is very networked and knowing the right people is essential to build business relationships. Thus, both language and cultural barriers are high. Many Korean companies address this by appointing a Korean native country manager, but this can have the negative side effect that a local culture emerges, which does not connect well with the company's international culture and way of working.

Demographic trends and student exchange increasing openness

The South Korean economy has recently started to show signs of increased internationalization. This creates possibilities for foreign companies to enter the market. One of those reasons is demographics, or more specifically, the aging population and shrinking workforce. Low fertility rates and increased life expectancy are driving the aging trend; South Korea is quickly catching up Japan and the aged population is expected to reach 42% of the total population by 2050 (figure 10). South Korea will have to open its doors to foreign workforce and business to be able to maintain its prosperity as its domestic demand decreases.

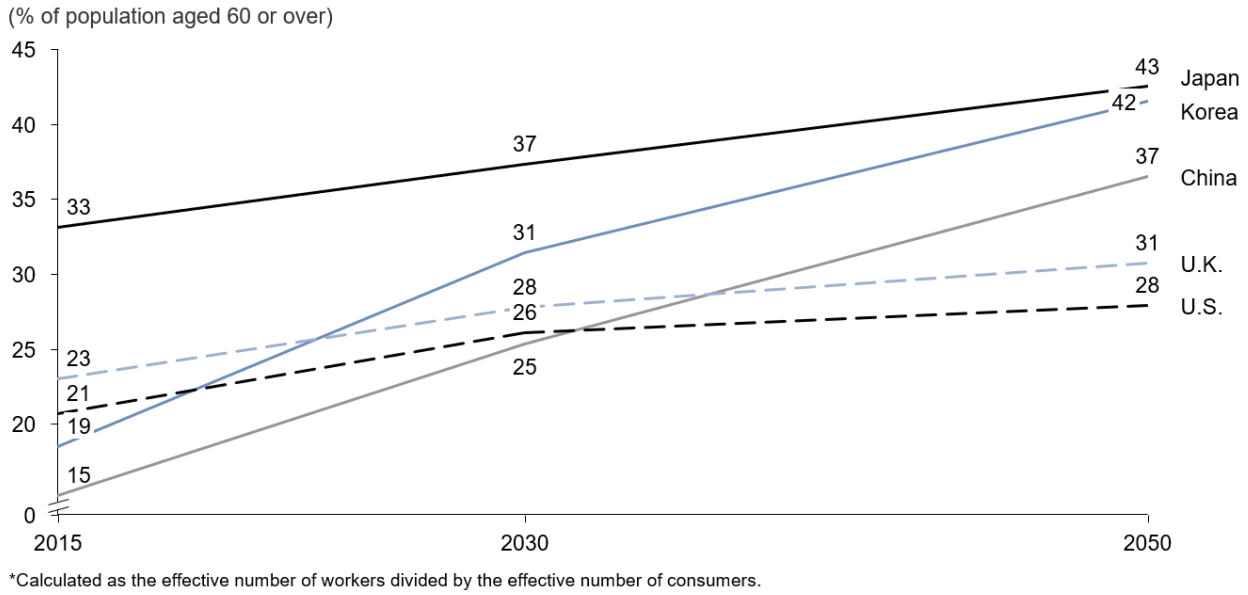


Figure 10. Share of population aged 60 or over by countries (%) [25].

South Korea's trend of internationalization is further demonstrated by the growing number of young Koreans studying abroad. English language education is deemed very important in South Korea and many Koreans spend extended periods abroad to hone their English skills. There are currently more than 100 000 Korean students in the US, making Korea the top student-sending country in the world. This is lowering the language barrier and opening new opportunities for foreign companies seeking multi-language employees.

Younger Koreans have also learned the benefits of an international environment and are not protectionist to the extent of the generations before them. While the economy has developed thanks to the chaebols, admiration for them is decreasing; the benefits of the chaebols to the economy and the job market are being increasingly questioned. Koreans, particularly those who have spent time abroad, often have new, less conventional ideas about their employment prospects. While landing a job in a prestigious chaebol is still the primary goal for most young graduates, a small but growing number of students are now looking for employment among startups. Some even consider starting their own businesses. These entrepreneurs rebel against traditional values in a country where a job title is the main metric for success. The new generation is also increasingly adopting a more Western work culture. Many tend to value a more balanced work life, instead of the long hours employees put in at the chaebols. According to a survey conducted in 2022, company's benefits, culture, and office location were the top three consideration factors among Generation-Z applications, while compensation was scored fourth on the list [27].

As part of such changes, in 2018, the National Assembly Committee on Environment and Labor passed a law to put a cap on weekly working hours to 52 [26]. This change demonstrates that more emphasis on work-life balance in society will challenge traditional values in a country and people's values when choosing a job.

Opportunities exist but require a solid entry strategy and understanding of the market

Chaebols dominate the South Korean business environment and direct competition with them is challenging. A market entrant could, however, prosper by targeting a niche that is too specialized for the big chaebols to enter, either directly or through their supplier network. Recent developments in the country's rising IT-startup sector may also provide new opportunities for foreign companies interested in entering the South Korean market.

Chaebols use generic suppliers in areas where they cannot obtain economies of scale, and a player entering such a specialized market could fly under the radar or even become a crucial partner. Such a niche is usually highly specialized, and the volume is not big enough to mandate serving only one chaebol. As an example of a successful market entry using this strategy, consider a Nordic company in the construction sector. It entered a niche market where the volume was too small to attract chaebols and where developing a product from scratch would have been too time-consuming. The market was further boosted due to the government's five-year plan at the time. The company has managed to build a significant market position, serving several major chaebols, by offering top-quality products and serving Korean customers while paying attention to the local cultural requirements.

Local manufacturing content also plays a big role, both for government procurement and major chaebols tightly linked to the government. Leveraging this, a Northern European industrial equipment manufacturer has succeeded in penetrating the South Korean market by acquiring local production facilities and developing a world-class manufacturing process, partly by learning from top chaebols in the automotive industry. Today, the company provides its high-quality equipment to multiple conglomerates across market sectors. The production facility also serves as a global production base for this specific product category, indicating that despite the somewhat higher labor cost, the South Korean plant has managed to reach a cost-competitive position on a global level. Success for this company builds on systematic development of a world-class production process, bringing top quality products to the market and working closely in a mutually beneficial approach with major chaebols.

In the IT-sector, the emergence of Android and iOS platforms started a revolution that has created new opportunities for startup ventures to flourish. With telecom, wireless broadband, cable and IT-infrastructure highly developed, the ecosystem provides easier market access to independent, innovative players. This has led to the emergence of local IT companies, now followed by the entry of venture capital seeking to reinforce the trend. A foreign IT-startup in South Korea could benefit from the large domestic market and the continued start-up and venturing boom. The local market is very advanced with South Koreans actively using their mobile devices for gaming, social networking, and anything else application developers can offer. Although Nokia failed in its entry into the Korean market, Finnish Supercell with its Clash of Clans became well known among Koreans.

Recruiting and marketing processes are crucial in the initial phase

The nature of the South Korean business environment makes recruiting the right people an essential factor for a successful market entry. The best Korean employees are unlikely to apply for work with an unknown foreign company lacking brand and credibility. On the other hand, the business culture depends highly on personal relationships, making it a difficult

market unless the company has a top-notch staff accustomed to the local business culture and with the right networks in place.

Consider the case of a Nordic industrial goods company. This company saw a clear market opportunity for its products. However, setting up a sales office took much longer than expected mainly due to staffing difficulties. After a great deal of challenges, the company found a senior manager willing to work for a relatively unknown enterprise. Unfortunately, the manager was “too senior” to drive crucial early stage frontline sales work, and evidently also lacked any real access to key decision makers. The headquarters sent mid-level management over to push the local operations forward but has so far not been able to change the situation markedly as these ex-pats do not have the required network.

Successful recruiting requires developing a strong company brand and word of mouth to compete with the better-known local players. The company’s vision for the future must be credible; marketing messages need to be tailored to meet the unique characteristics of the South Korean business environment. Topping this off by offering a better work-life balance can switch the recruiting advantage to the foreign company. A foreign company that succeeded in setting up its South Korean sales company found an entrepreneurial sales manager in his mid-30s with solid international experience and good knowledge of the Korean market. The manager preferred employment in an international company due to better working culture and saw the opportunity to build his own career in the company. The company had a good reputation, world-class products, and focused on markets where demand was building up yet no chaebols or their suppliers operated. In addition, the senior management members had spent considerable time in Asia and understood the unique characteristics of the market. They were willing to spend time and visit the Korean operations despite it being relatively small, which helped business to take off.

South Korea offers interesting learning opportunities and a gateway to a larger Asian market

South Korea remains relatively unknown to foreign companies and its potential is perhaps too often neglected. Granted, this country represents a somewhat closed economy, and due to language and cultural barriers, it is hard to enter. Nevertheless, the unique characteristics of this market offer the courageous entrant interesting learning opportunities and a gateway to large Northeast Asian markets. Success will require careful attention to efficiency and quality, as well as recruiting, marketing and brand building (often through informal networks), and the many obstacles that are likely to be found on the way. For those who survive the entry, the reward lies in working with one of the most dynamic economies in the world, having access to a highly educated, hardworking and ambitious staff, and collaborating with some of the largest and fastest growing global corporations.

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