

Korea as the Next Business Hub of Asia

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In December 2001, AMCHAM Korea decided to conduct a business environment survey with regional executives in the Asia Pacific region in order to understand how key business executives in the Asia Pacific region perceived Seoul as a world city and Korea as a regional hub compared to its neighboring nations. A 20-page survey was sent out to approximately 2,000 executives in more than 120 multinational companies (MNC) with business interests in Asia and approximately 85% of them responded. Key executives in cities traditionally considered as regional business hubs in Asia such as Hong Kong, Singapore, Shanghai and Tokyo were asked to comment on areas including tax, foreign exchange controls, labor flexibility issues, lifestyle issues among other relevant subjects. Executives in Seoul also participated in the survey and key executives were interviewed for recommendations based on actual experience.

The primary purpose of our extensive study is to assist the Korean government with its Asian business hub initiative. Although Korea has achieved remarkable progress in making economic reforms and continues to be a key trade partner for the US (6th largest export market & US\$ 68.2 billion in two-way trade in 2000), the way Korea is perceived by global business executives does not match its current status quo. Since the 1997 Asian financial crisis, the Korean government has been making drastic improvements in its business environment to attract foreign business into Korea. This year, the Korean government has launched a campaign specifically targeting multinational corporations to attract their Asia regional headquarters to Seoul. Korea's unique geographic position and strong domestic economy should make it an ideal location for regional headquarters. However, most multinational corporations looking to open a regional office in Asia rarely consider Korea as the ideal place to do business and often omit Korea from the preliminary selection process. From the Korea Business Environment Survey (KBES) and through subsequent interviews, AMCHAM Korea identified five key areas of

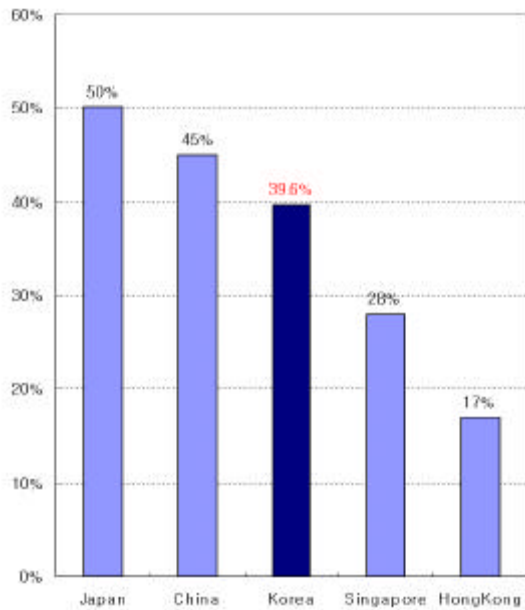
improvement needed for Korea to be considered as a regional hub destination. By improving current tax rates, foreign exchange controls, labor flexibility issues, English language skills, and country image, Korea can be better positioned for becoming the next Asian business hub.

Overall, Korea ranked last among the cities surveyed, behind Hong Kong, Singapore, Shanghai, and Tokyo. In general, MNC executives who participated in the KBES perceived Korea as an unattractive place to do business. Korea suffered from negative perceptions, many irrelevant to Korea's current environment. For example, although Korea's domestic economy was perceived to be in good shape, regional executives perceived the global business environment to be least competitive compared to Hong Kong, Singapore, Tokyo and Shanghai. Many regional executives understand the potential economic benefits of doing business in Korea; however, it was found that they do not perceive Korea to be an ideal place for doing a long-term business mainly due to uncompetitive tax rates, complex foreign exchange regulations, and labor flexibility issues.

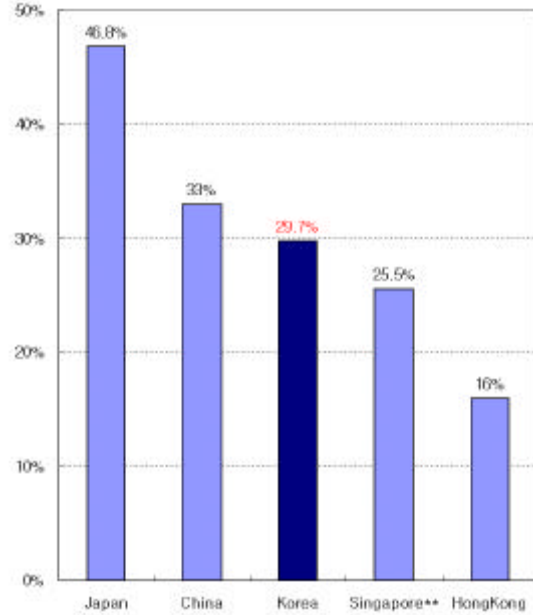
TAX

First, Korea ranked 3rd in tax environment after Hong Kong and Singapore, but before Tokyo and Shanghai. Using the other surveyed cities as their reference group, 84% considered Korea's personal tax rates as high while 92% considered Korea's corporate tax rates as high. As of January 2002, Korea's maximum tax rates were at 29.7% for corporate and 39.6% for personal rates. When Singapore's Overseas Headquarters (OHQ) regime is taken into consideration, Korea's corporate tax regime seems unreasonably unattractive to MNCs in search of a location for their regional headquarters. Singapore's OHQ regime provides tax incentives to MNCs with regional headquarters in Singapore. Any company with OHQ status is taxed at the flat rate of 10%. Korea's personal rates are uncompetitive compared to Singapore and Hong Kong. Singapore and Hong Kong's maximum rates are currently at 28% and 17%, respectively.

<chart 1> Personal Tax Rate



Corporate Tax Rate



** Singapore has implemented the OHQ Regime that give special tax incentives to corporations with regional headquarter status in Singapore. OHQs are taxed at 10% flat rate.

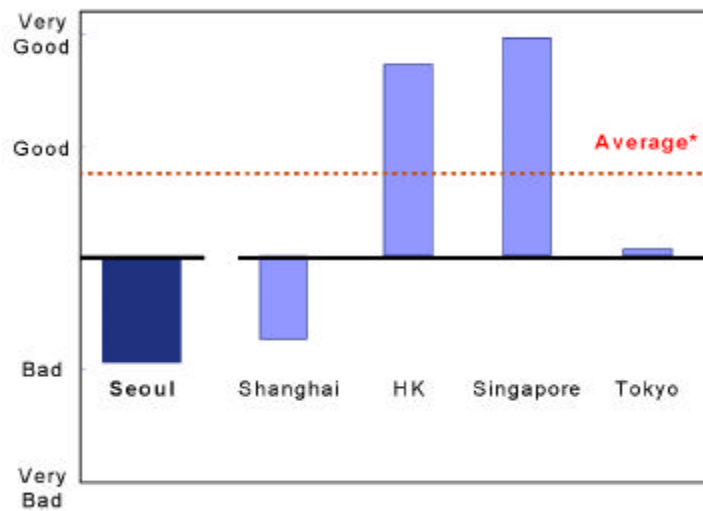
As an effort to offer some tax initiatives that match Hong Kong and Singapore's, Korea announced a new tax rate for the foreign investors in Korea: the companies that invest more than US\$50 million in the Foreign Investment Zone are exempt from all taxes for 7 years and will receive a reduced rate of 50% for 3 years after that, and the companies investing more than US\$10 million in the Special Economic Zones (SEZ) get a 50% reduction for 2 years after 3 years of exemption.

Foreign Exchange Control

Second, Korea's overall foreign exchange environment was considered poor. Burdensome reporting and approval requirements on inward and outward remittances that can lead to sanctions will not attract multinational corporations to Seoul, let alone their Asia regional headquarters. Korea ranked last in foreign exchange control environment. 89% of regional executives felt Korea's foreign exchange controls were too complex, making it difficult for MNCs to

freely move funds in and out of Korea. Furthermore, many executives doing business in Seoul felt that current regulations cause unnecessary complications in intra-company transactions. Korea is faced with steep competition from Hong Kong and Singapore in this area. Hong Kong and Singapore have abandoned its foreign exchange controls; therefore, Korea will need to eliminate its foreign exchange controls in order to truly compete in this regard. Korea is currently ranked 4th in the world in foreign exchange with US\$104 billion in reserve, and is 3 years ahead of schedule in paying back the funds it borrowed from the IMF during the financial crisis in 1997. With this achievement, Korea is loosening its tight regulation on the foreign exchange controls. AMCHAM fully supports the Korean government in its reform initiatives.

<chart 2> Survey Result-Foreign Exchange Control



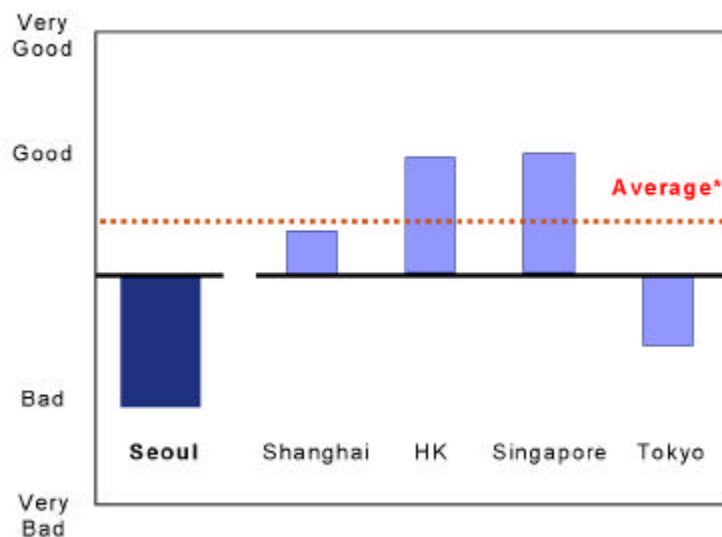
* The averaged value does not include Seoul

Labor Flexibility

Third, Korea also ranked last in labor flexibility. 92% of the regional executives felt it was vital to be able to adjust its work force to meet today's changing demands and business cycles. Without labor flexibility, companies will

never seriously consider Korea the location for their Asian regional office. Korean labor law places restrictions on what they call “dismissal for managerial reasons. This law does not provide equal protection for the interests of labor and management. A company cannot freely downsize until it is facing a financial crisis, which is then too late. Korea will need to reform its labor laws so that the law provides a greater balancing of interests between labor and management. Also, the union often times is too militant and does not hesitate to carry out violent protests.

<chart 3> Survey Result-Labor Flexibility



* The averaged value does not include Seoul

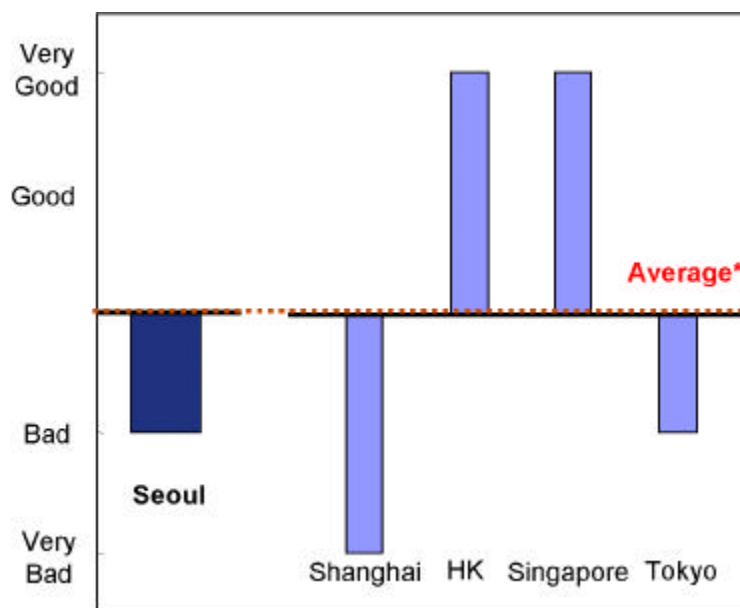
While these factors are disadvantageous to Korean labor, there are also the benefits. Workers in Korea are generally highly educated and efficient. Also, the wage is about a third of that in America. Korea's minimum wage is only KRW 2100/hour, about US\$1.75/hour with the current exchange rate, compared to America's which is approximately US\$6/hour.

English Communication Skills

Fourth, Korea ranked 3rd after Hong Kong and Singapore in English

communication skills. Korea did better than Shanghai and Tokyo, however. Taking into consideration Hong Kong and Singapore's history, it is only logical for Korea to lag behind in terms of English communication skills of its population. Most common remarks were focused on the fact that although over 90% of TOEIC test takers score above average on the tests, their verbal and written communication skills in English were surprisingly ineffective. For a company looking to establish its regional headquarters in Asia, one of key judgment criteria would be the supply of qualified workers. Regional staff must be able to communicate their ideas effectively to other affiliates as well as the headquarter office while possessing the ability to think globally and make sound business decisions. In order for Korea to become a regional hub in Asia, its people will need to develop effective verbal and written communication skills in English.

<chart 4> Survey Results-English Language Skills



* The averaged value does not include Seoul

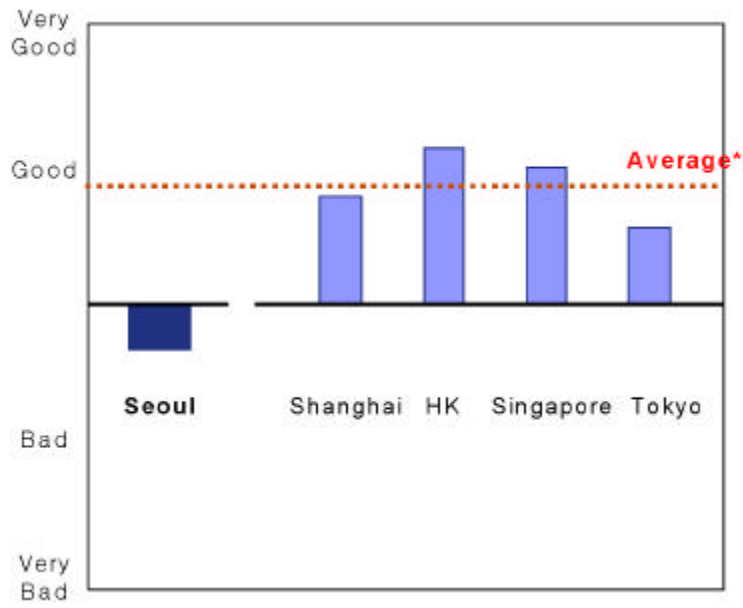
National Image

Lastly, Korea ranked last in prestige. 59% of regional executives perceived Korea as the least attractive place to live and work in. Most expatriates living in other Asian cities rated Seoul negatively; however, our secondary interview results showed that business executives living in Seoul viewed Korea favorably. In order to close the gap that exists between Korea's current image and the reality, Korea needs to first establish what the gap is, then plan and launch a long-term cohesive image campaign to improve its global image. A well-planned image campaign can contribute to increased currency stability, investor confidence, global political influence, inbound tourism and export of branded products and services. A well-planned image campaign should improve Korea's current image in the world by focusing on Korea's relevant assets and achievements.

Germany, Scotland, Spain, Britain, Canada, Thailand and New Zealand all have launched image campaigns in recent years which have served as platforms to promote some undisputed qualities and in certain cases have inspired an improvement in quality. Korea needs to understand that launching a reality based image campaign is a significant and long-term project, but it is not impossible. With the right team with a realistic project and implementation plan, Korea should be able to make drastic improvements because it already has the right elements in place.

Korea's recent success in co-hosting the 2002 FIFA WorldCup Korea/Japan should be used as a springboard to jump start an image campaign to brand Korea. Taking full advantage of the global attention, Korea boasted its world's top IT infrastructure and its potential of growing into a Logistics and Financial Hub of Asia. It is time for Korea to move aggressively in this area.

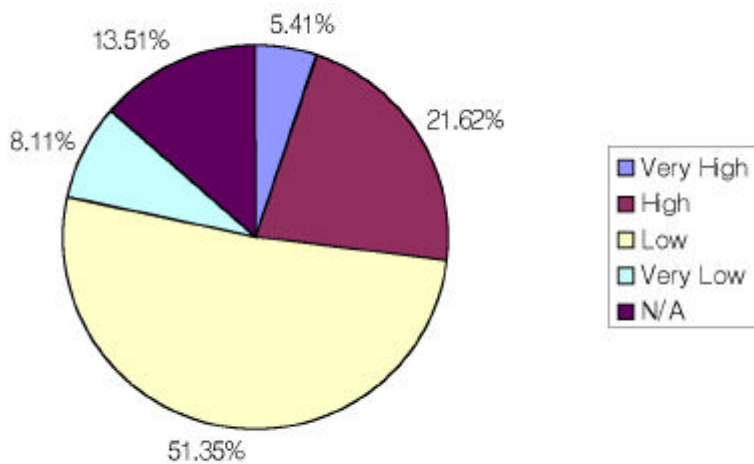
<chart 5> Survey Result-Country Image / Prestige



* The averaged value does not include Seoul

Perception

Question: Please rate the prestige factor of Seoul using other Asian cities previously mentioned as your reference group.



Living Environment

Although these five areas are the crucial factors for foreign investment in Korea, the real deciding vote comes from the living environment. The main reason for the MNC executives who decline their assignments in Korea is because Korea lacks quality foreign schools. According to a recent study conducted by the Seoul City government, most of the 60 foreign schools in Korea are not accredited, and lack adequate facilities and teachers. Other areas that need improvements are housing, shopping malls, government offices, gyms and hospitals. Easy access to places like these are needed if Korea wants to attract expatriates to Korea, and for them to enjoy their life during their stay in Korea.

R&D

With China growing as the biggest market and Japan already established as an economic leader, it is an uphill battle for Korea to attract MNCs to build their Research and Development (R&D) centers here. For Korea to edge out neighboring competitors, Korea needs to offer for the MNCs some attractive incentives.

First, the government aid should be available to facilitate the R&D industry. The Korean government raised its investment in science & technology sector (S&T) from US\$ 480 million in 1980 to US\$ 12.2 billion in 2000. Despite the financial crisis in 1997, Korean government has raised its research and development expenditures from 3.6% (US\$ 3 billion) of its total budget in 1998 to 4.7% (US\$ 3.8 billion) in 2002. The “Presidential Science Scholarship” has been established to increase the participation from women researchers, and in order to give the scientists the recognition of their achievements, a “National Award for Eminent Scientists and Engineers” has been instituted. The manpower involved in R&D has also increased from 18,500 to 160,000 in the past two decades. Korea is well on its way to establishing the fundamentals needed to become the R&D center.

<chart 6> R&D by industry: Current R&D trend by the MNCs in Korea

| Types of industry | Number of Answers (#,A) | Total Sales (KRW 100 million ,B) | R&D expenditure (KRW 100 million) | | C/A (KRW million) | D/A (KRW million) | C/B (%) | D/C (%) |
|-------------------|-------------------------|----------------------------------|-----------------------------------|----------|-------------------|-------------------|---------|---------|
| | | | 2001 (C) | 2002 (D) | | | | |
| Electronics | 19 | 2,541.6 | 115.0 | 126.1 | 6,052.4 | 6,637.0 | 4.52 | 9.7 |
| Chemical | 25 | 14,209.6 | 114.0 | 111.6 | 4,559.6 | 4,463.3 | 0.80 | - 2.1 |
| Machinery | 15 | 2,421.5 | 88.6 | 99.3 | 5,906.9 | 6,622.9 | 3.66 | 12.1 |
| Others | 4 | 285.1 | 11.0 | 11.4 | 2,746.8 | 2,845.0 | 3.85 | 3.6 |
| Est. before '94 | 28 | 5,220.2 | 204.8 | 211.4 | 7,315.8 | 7,548.3 | 3.92 | 3.2 |
| Est. '95j- '97 | 11 | 12,655.5 | 101.3 | 106.3 | 9,208.4 | 9,664.5 | 0.80 | 5.0 |
| Est. after '98 | 24 | 1,582.1 | 22.4 | 30.7 | 935.1 | 1,281.1 | 1.42 | 37.0 |
| Total | 63 | 19,457.7 | 328.6 | 348.4 | 5,215.5 | 5,530.3 | 1.69 | 6.0 |

Second, the infrastructure must be improved to meet the needs of the global market. The Korean government will be spending over US\$ 300 billion on infrastructure projects over the next 20 years: developing airports, railroads, ports, etc. Foreign Investment Zones(FIZ) and Special Economic Zones(SEZ) have been set up in key areas around the peninsula, with the major one being in Incheon. These initiatives are to enhance the living environment of foreign workers in Korea.

<chart 7> R&D trends of MNCs in Korea (#(%))

| Types | | Structure of R&D Industry | | | Types | | Structure of R&D Industry | | |
|--------------------------|------------|---------------------------|---------------------------|------------|----------|-------------------------|---------------------------|---------------------------|------------|
| | | Laboratory | Dept. Responsible for R&D | Total | | | Laboratory | Dept. Responsible for R&D | Total |
| Country | US | 46(45.1) | 5(25.0) | 51(41.8) | Industry | Electrical/ electronics | 42(41.2) | 5(25.0) | 47(38.5) |
| | EU | 35(34.3) | 6(30.0) | 41(33.6) | | Chemicals | 30(29.4) | 10(50.0) | 40(32.8) |
| | Japan | 13(12.7) | 5(25.0) | 18(14.8) | | Machinery | 24(23.5) | 1(5.0) | 25(20.5) |
| | Others | 8(7.8) | 4(20.0) | 12(9.8) | | Others | 6(5.9) | 4(20.0) | 10(8.2) |
| Size of the Corporations | Big | 27(26.5) | 10(50.0) | 37(30.3) | Region | Seoul | 31(30.4) | 4(20.0) | 35(28.7) |
| | Mid/ Small | 75(73.5) | 10(50.0) | 85(69.7) | | Kyung-Ki Incheon | 29(28.4) | 9(45.0) | 38(31.1) |
| Year of Establishment | Before '94 | 38(37.2) | 4(20.0) | 42(34.4) | | Choong - Chung | 18(17.6) | - | 18(14.8) |
| | '95j- '97a | 17(16.7) | 2(10.0) | 19(15.6) | | Young - Nam | 18(17.6) | 3(15.0) | 21(17.2) |
| | After '98 | 47(46.1) | 14(70.0) | 61(50.0) | | Ho - Nam | 5(4.9) | 4(20.0) | 9(7.4) |
| | Others | 1(1.0) | - | 1(0.8) | | Others | 1(1.0) | - | 1(0.8) |
| Total | | 102(100.0) | 20(100.0) | 122(100.0) | Total | | 102(100.0) | 20(100.0) | 122(100.0) |

Korea's world class information systems, which includes data collection, software application and distribution will expedite the technology and information transfer from R&D institutes and universities to industry. The Korean government should promote R&D and nurture public's interest in science, and

aim to influence the next generation to become creative and innovative researchers.

Third, the laws must be altered to encourage foreign participation in the process. According to the Collaborative R&D Promotion Law, the government encourages industry, academia and research institutes to establish a consortium for joint R&D by providing financial and administrative assistance. Also, the reinforced Korean legal system for intellectual property rights protection encourages new invention and innovation of R&D by protecting the rights of the inventors. Improvements for foreign schools, immigrations regulations and the research management system being underway is good news for Korea. Korea should continue to make this progress.

Despite the global economic slowdown in 2001, Korea enjoyed more FDI and is currently hosting over 10,000 MNCs, including 204 of Fortune 500 companies. With its geographical advantage of being within hours from all major cities in Asia, including Japan and China, many MNCs choose Korea to build their R&D centers. J. P. Morgan and Deutsche Bank predicted Korea's Economic Growth Rate in 2002 to be 4.0% and 6.5%, respectively. The fact that these numbers are higher than what was predicted by Samsung(3.0% to 5.0%) shows that Korea is gaining the trust and confidence of the MNCs and foreign investors.

<chart 8> Trends of MNCs in Korea

| Company | Industry | Details |
|-----------------------|------------------------|--|
| Ford | Automobile | Increase of exhibition and repair factory |
| Sony | Electronics | Increase of A/S centers from 40 to 50 |
| Clark | Construction/Machinery | Core R&D center & manufacturing facilities move to Korea |
| Olympus | Camera | 30 retail outlets increase to approx. 60 |
| JVC | Electronics | Enlargement of distribution structure |
| Swatch | Watch | Swatch Korea operated by Swatch HQ. First international A/S center established |
| BAT | Tobacco | Construction of a manufacture factory |
| Boeing | Airline | Korea selected as Boeing's Top 10 strategic markets |
| Fuji Heavy Industries | Automobile | Preparing for the Korean market entry, following Toyota's lead |

Source: Donga Ilbo, 2002. 3.

Korea should continue to focus on developing its strong points: its intelligent people and R&D capabilities.