

KERI **E**CONOMIC **B**ULLETIN

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Korea Economic Research Institute

Executive Summary

Korea's 2014 GDP growth projected at 3.5%

Korea's economy for 2014 is expected to maintain its modest uptrend in accordance with the gradual improvement in global conditions and through implementing policies that aim to restore demand for Korean goods and boost supply-side supports. Despite gradual upturn in global growth, led by the US, a range of downside risks, such as tapering of asset purchases by the US Federal Reserve, the weakening yen, slowdown of the Chinese economy, falling of USD/KRW and rampant trade protectionism, will slow the pace of Korea's export growth. Internally, turbulence is expected on the horizon. The effects of economic stimulus measure to buoy economic growth will likely to be offset by the deleveraging process of household debts, dampened investor sentiment and limited financing capability, all of which are projected to offset the effects of economic stimulus measure to buoy economic growth.

Consumer prices grows slow at 2.2%, a large current account surplus continues of US\$76.6 billion and USD/KRW to mark a gradual fall (1,068 won/\$ on annual average)

The upward pressure of public utility charges and base effect is forecast to send consumer prices in 2014 to slightly increase, comparable to the average rate at 1.3% in 2013, but its effects are limited at around 2.2 %, owing to fall of USD/KRW and the stabilizing trend of the international prices of raw materials. Korea's current account balance is projected to continue posting a sizeable surplus of US\$76.7 billion in 2014, attributable to a large goods balance surplus, which outweighs a small increase in services account deficit. USD/KRW is expected to show a gentle descend at 1,068 won as strong won factors, such as current account surplus are offset by strong-dollar factors following the US Fed's tapering.

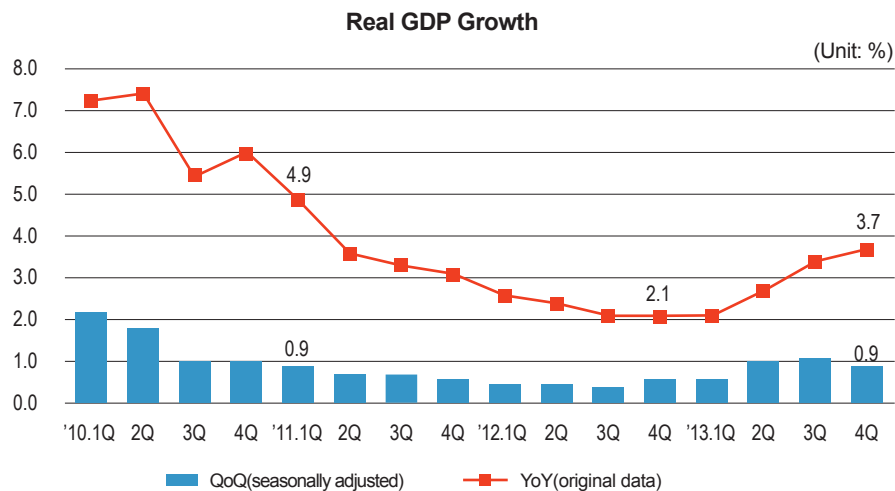
Amid delay in medical tourism development due to public debate over possible damage to its "publicness", a 'comprehensive, regulation-free medical tourism cluster' is suggested as a viable policy alternative

In order to create more jobs and secure the growth engine, the service sector revitalization is crucial, and medical tourism is of prime importance in reinvigorating the sector. Considering its advance level of surgical skills and price competitiveness, Korea's medical service sector poses great potential: its effect on production inducement is estimated to be 11.6 trillion won and 84,000 additional jobs by 2020. Regulations restricting the healthy cycle of supply and demand of medical services must be lifted immediately. However, taking into consideration an existing filibuster among some critics over possible damage to the medical service sector's 'publicness' we suggest building of a 'comprehensive, regulation-free medical tourism cluster' as a viable policy alternative and an initial step forwards the deregulation of medical service sector.

Recent Developments

GDP growth records 0.9% (QoQ) in 4Q 2013 from 1.1% in 3Q, but is forecast to sustain a gradual recovery

Taking into consideration the base effects of maintaining growth at the 1% range for the last two consecutive quarters, the Korean economy in 4Q grew 0.9% (QoQ, seasonally adjusted) or 3.7% annually, approaching near the potential growth level.



Source: The Bank of Korea

Transition from a public-led growth to a privately sustained recovery still remains unsatisfactory

Contribution from public finances, such as public expenditure and construction investment has receded after two consecutive quarters in 2013. Contribution from private expenditure, such as facility investment and export has slightly increased but its effects were offset by diminishing contribution from the private consumption.

Contribution to GDP by Expenditure

(Unit: %p, QoQ sa)

	2012				2013			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Final consumption expenditure	0.8	0.0	0.7	0.3	0.0	0.6	0.6	0.4
Private	0.4	0.1	0.6	0.2	-0.1	0.3	0.5	0.3
Government	0.3	-0.1	0.1	0.0	0.1	0.2	0.1	0.1
Gross fixed capital formation	1.1	-1.1	-1.3	-0.8	0.8	-0.1	1.0	1.3
Construction	-0.3	-0.5	0.2	-0.4	0.9	0.7	0.0	-0.8
Facilities investment	1.1	-0.8	-0.3	-0.3	0.1	0.1	0.2	0.5
Exports of goods and services	0.3	1.4	1.1	0.5	0.1	1.5	-0.6	0.8
(less) Imports of goods and services	1.6	-0.1	0.2	-0.7	0.3	0.9	-0.2	1.5
Expenditure on GDP	0.8	0.3	0.0	0.3	0.8	1.1	1.1	0.9

Source: Bank of Korea

Exports growth (on a custom clearance basis) picks up as it recorded 0.4% in 1Q, 0.7% in 2Q, 2.8% in 3Q, 4.7% in 4Q and 2.2% in 1Q, 2014

The daily volume of exports accelerates to 2.8% (YoY) or US\$2.08 billion in 1Q 2014. By region, exports to US and EU started to take a favorable turn, while exports to Japan continued to be sluggish.

Export Growth and Daily Average Export Volume

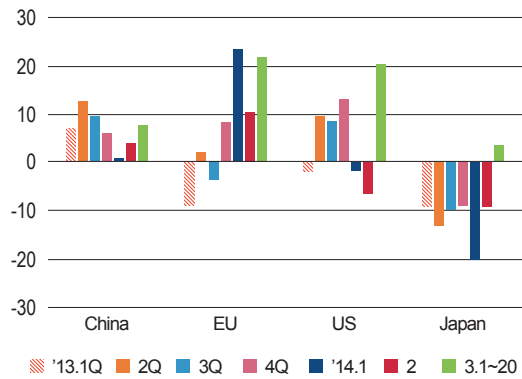
(Unit: left-YoY%, right-US\$100mil)



Source: MOTIE, Korea Customs Service

Export Growth by Destination

(Unit: YoY%)



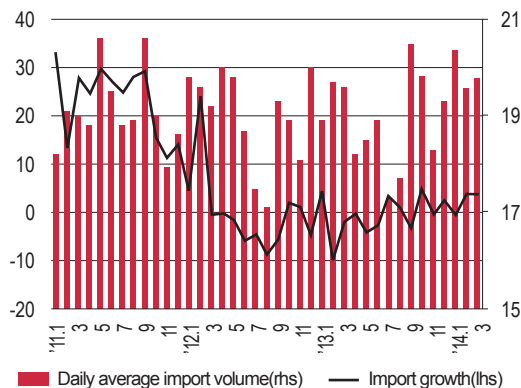
Source: Korea Customs Service

Imports growth (on a custom clearance basis) recorded -3.0% in 1Q and -2.8% in 2Q but rebounded to 0.2% in 3Q and 2.5% in 4Q. In 1Q 2014, the growth records at 2.1%

The daily volume of imports in 1Q recorded a 2.9% increase (YoY) or US\$1.99 billion. By sector, raw material imports, which constitute the largest share of total imports, start to decrease while imports of capital goods and consumer goods continue to expand.

Import growth and Daily Average Import Volume

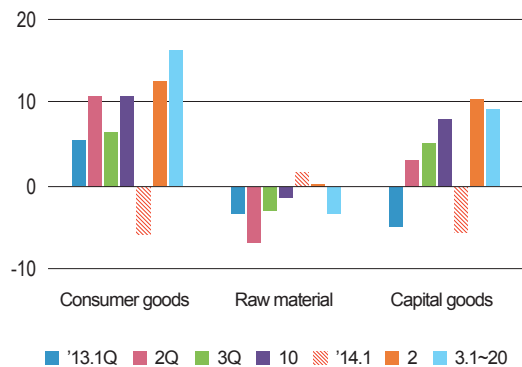
(Unit: left-YoY%, right-US\$100mil)



Source: MOTIE, Korea Customs Service

Import growth by use

(Unit: YoY%)



Source: Korea Customs Service

Korea's yearly current account surplus hits record high at US\$79.88 billion; Its 2014 surplus is forecast to remain high, posting US\$7.81 billion between January and February

Korea's Current account surplus widened between January and February 2014 by US\$3.69 billion, compared to US\$4.12 billion from the same period a year ago.

Trend of Current Account

(Unit: US\$billion)

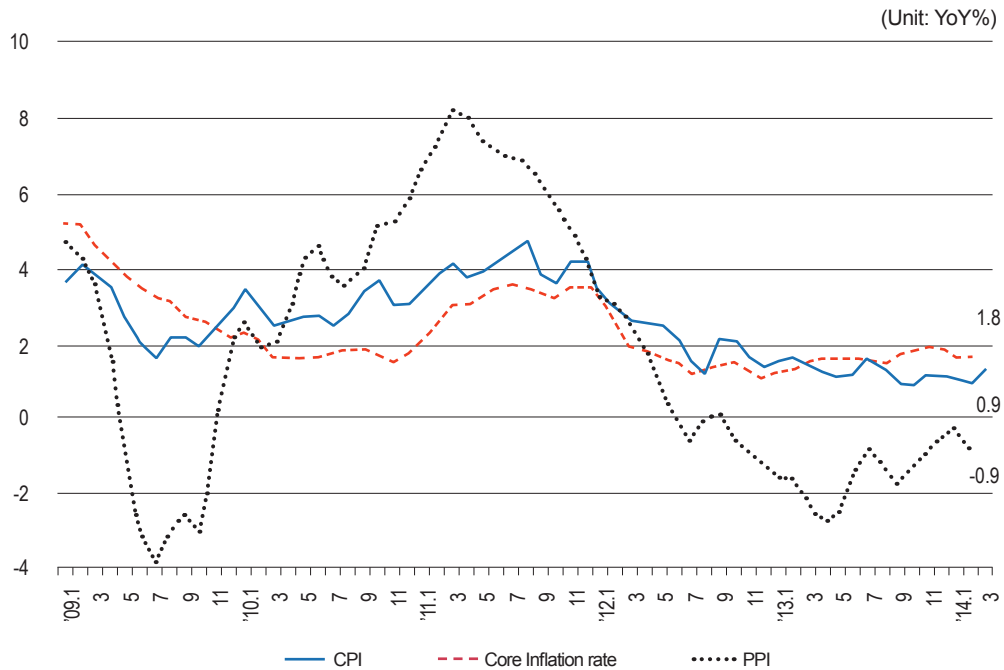
	2012	2013				2014		
	Year	1H	2H	Year	Jan~Feb	Jan	Feb	Jan~Feb
Current Account	508.4	312.6	486.2	798.8	41.2	32.9	45.2	78.1
Bal of Goods	494.1	320.8	485.0	805.8	55.9	43.7	54.3	98.0
Bal of Services	-52.1	-39.2	-40.0	-79.2	-31.8	-19.1	-10.6	-29.7
Bal of Primary Income	121.2	46.2	68.0	114.2	24.7	12.1	3.7	15.8
Bal of Secondary Income	-54.7	-15.1	-26.7	-41.8	-7.6	-3.8	-2.2	-6.0

Source: The Bank of Korea

Consumer prices show signs of abating since November 2013, maintain at a close to the deflation line

Slump in the demand side, together with the weak upward pressure of the supply side, attributable to fall of raw material prices, pull down the upward pressure of consumer prices. Earlier, upward pressure was substantially diminished following a major decline in raw material prices and stabilization of prices of agricultural, livestock and fishery products. Producer prices continue to decline for the 17th consecutive month since October 2012.

Trend of Increase of Prices



Source: Korea Customs Service, The Bank of Korea

Employment continues to record quantitative growth for all age groups

The number of employees increased by 835,000 in February 2014 compared to that of February in the previous year. Although unemployment rate increased to a 4.0% rate in the period between January and February 2014, the upturn is ascribable to the rise in the economic activity rate, and does not signify worsening of the labor market conditions.

Employment-related Indicators

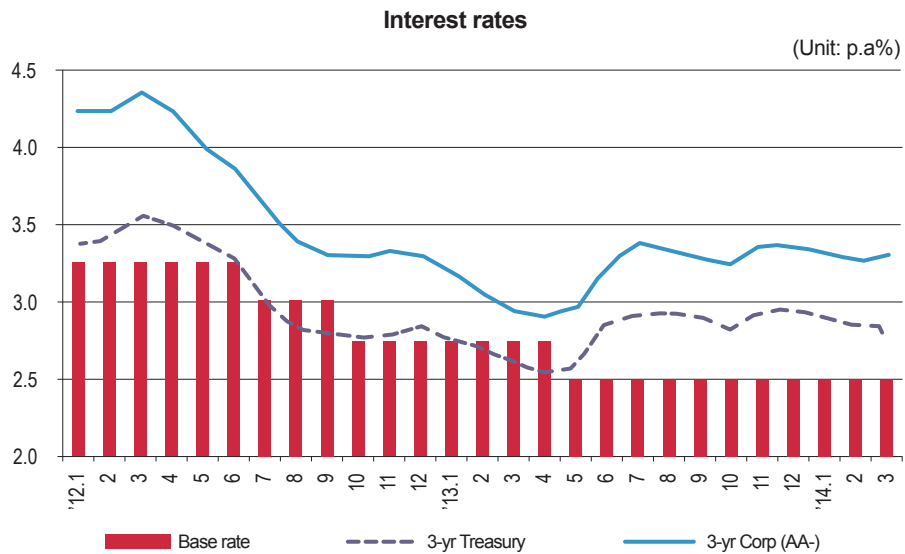
(Unit: thousand persons change over year ago, %)

		2013				2014	
		1Q	2Q	3Q	4Q	Jan	Feb
Changes in number of employed persons		257	324	421	541	705	835
Age	- 15 ~ 29	-117	-88	-41	46	74	148
	- 30 ~ 39	-15	8	-34	-42	11	-6
	- 40 ~ 49	12	-6	30	53	90	109
	- 50 ~ 59	196	254	279	285	320	357
	- 60 years and older	181	156	187	200	210	228
Unemployment rate (%)		3.6	3.1	3.0	2.8	3.5	4.5

Source: Economically Active Population Survey (Statistics Korea)

Market interest rates on a secular rise as Federal Reserve Chair Janet Yellen signals gradual tapering

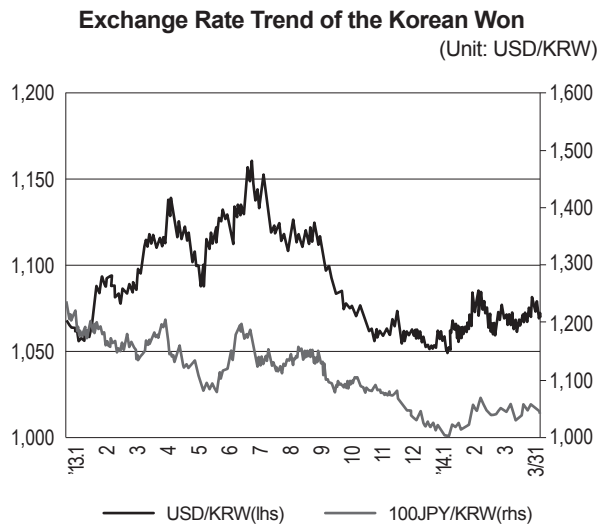
The upward pressure of market interest rates stayed weakened since November 2013 but started rising at a gentle pace as expectation for the domestic base interest rate fall weakened following wide vigilance at the beginning of US Fed's tapering in March and after its Chair hinted that the interest rates in the US could start to rise in early 2015. The upward pressure of market interest rates stayed weakened since November 2013 but started rising at a gentle pace as expectation for the domestic base interest rate fall weakened following wide vigilance at the beginning of US Fed's tapering in March and after its Chair hinted that the interest rates in the US could start to rise in early 2015.



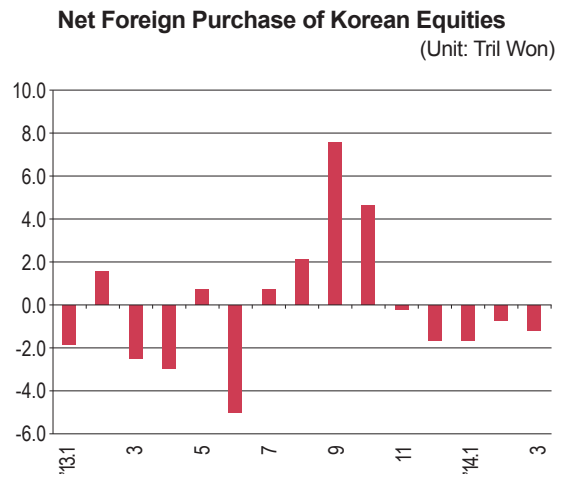
Source: The Bank of Korea

USD/KRW shows a gentle rebound following the US scaling down of QE and expectations for China's economic hard landing, amid Korea's sound fundamental such as its prolonged current account surplus

Despite a large surplus in 2013 which is projected to continue well into 2014, USD/KRW is showing a gentle rise. Vigilance over adjustment post QE downsizing and China's possible hard landing has driven USD/KRW to 1,055 won during the months of January and February, and 1,069 on 31 March.



Source: The Bank of Korea



Source: The Bank of Korea

Outlook for 2014

1. External Environments

(World Economy) Amid impending US Fed's initiatives to phase out quantitative easing in 2014, overall global economy is projected to show a gradual recovery, anchored by the developed economies

(United States) Recovering from a slump in Q1 due to frigid weather conditions and inventory adjustment, the economy is expected to pick up, accelerated by increase in investment, which will lead the recovery of housing and consumer markets.

(Eurozone) Amid lingering risks associated with high levels of unemployment and possible deflation, the Eurozone economies are forecast to gain a gradual recovery, buoyed by sound projection of the Economic Sentiment Indicator (ESI) and possible corporate investment increase, following favorable market conditions, such as financial market rebound, low market interest rates and debt deleveraging.

(Japan) The growth for 2014 is projected to be slower than that of 2013, owing to falling public and corporate sentiments as positive impacts caused by the weak-yen sustained exports begin to expire. In addition, Japan's impending consumption tax hike scheduled in 2Q will likely to dampen the sentiment further.

(China) Midst of ongoing structural reform measures, a number of indicators—fixed asset investment, retail sales and exports—point to a gentle slowdown in economic growth.

(Oil prices) Despite the increased demand from the advanced economies, global demand for crude oil is forecast to be outweighed by global supply, owing to increased supply of crude oil and crude oil alternatives such as shale gas. Oil prices in 2014 are expected to show a downward stabilization trend

(Demand side) Demand from emerging markets is expected to decrease owing to shocks following the Fed tapering. However, the demand for crude oil from advanced economies is forecast to outgrow the fall, resulting an overall increase in the demand side.

(Supply side) Non-OPEC production increase boosted by the US is expected to drive a solid supply side recovery. However, a heap of geopolitical risk factors such as political instability in South Sudan, Libya and the Ukrainian crisis as well as the impending round of nuclear negotiations with Iran in May remain.

(Foreign exchange rates of major economies) The US dollar is projected to stay strong against the majority of its Forex counterparts, supported by the strong fundamentals which denote the economy is improving steadily. The Japanese yen and Chinese yuan are expected to fall against the dollar. The Euro is expected to moderately depreciate against the dollar, but it will see small fluctuations throughout, depending on the pace of economic recovery against its US counterpart.

(USD) The US dollar is projected to stay strong due to elimination of the winter slump in 1Q and following expectation that improving labor and housing markets contribute to the economic rebound, including facility investments.

(Euro) The euro is forecast to depreciate due to the eurozone's high level of unemployment rate, delayed banking sector reform, and concerns over possible increased burden of replaying existing loans as deflation draws closer in the southern Europe.

(Yen) To mitigate adverse effect of consumption tax hike on its economic resilience, the central bank is expected to maintain its large-scale asset purchases; the yen is forecast to stay weakened in 2014, although the rate at which it is dipping will be slower than that of 2013.

(Yuan) Midst on-going structural reforms underway, the Chinese economy is expected to witness a slowdown in retail sales and export, owing to decrease in fixed asset investment and expectation that credit expansion will be curtailed.

2. Outlook for Korean Economy in 2014

Growth: 3.0% in 2013 → 3.5% in 2014

Although the Korean economy is expected to maintain a gradual recovery in the second half of 2013 following improvement in external conditions and effects of domestic policies, its pace is expected to stop short in the mid 3% range. The global recovery is projected at 3.7% growth (IMF), short on the annual average of 4.2% during the period between 2000 and 2007. At home, current domestic conditions such as beginning of household debt deleveraging process, dampened corporate investment sentiment, and limited financial capability will act as barriers for the government stimulating measures to take full swing. However, domestic consumption, which outpace exports for the first time since 2010, is expected to lead the growth trend, steady and balanced between the first and the second half of 2014. The growth rate was revised up from earlier estimates due to the changes in the base year and the Bank of Korea's adaptation of new international standards on calculating gross domestic product from March, resulting in an upward revision of the rate to 3.5% from the previous 3.4%.

Private consumption: 2.0% in 2013 → 2.6% in 2014

Supported by increasing real purchasing power, attributable to stable inflation rates and the fall of USD/KRW, and improving labor conditions at home, the private consumption is forecast to show a steady rebound. However, constraint factors such as debt deleveraging and price hikes of the key money in the housing market will keep the level around the mid 2% range.

Facility investment: -1.5% in 2013 → 5.6% in 2014

Construction investment is projected to turn around and show a gradual rise, attributable to favorable conditions due to base effect, export recovery, fall of import costs of raw materials following the won appreciation. However, downward risks such as possible interest rate hike and policy implications relating to economic democratization that run contradictory to investment promotion may discourage investment sentiments

Construction investment: 6.7% in 2013 → 2.6% in 2014

Midst ongoing mid- to long-term structural reforms taking place in the real estate market, an SOC budget cut for 2014 is forecast to dampen the growth rate of construction investment in 2014, comparable to that of 2013. Construction order, a key indicator for construction investment, displayed a decline since 2Q 2012, indicating a steady slowdown of construction investment.

Export growth (BOP basis):
2.3% in 2013 → 4.8% in
2014

Gradual recovery trend of major economies, including the US is expected to be a positive factor in boosting Korea's exports. However the rate at which it is growing will be offset by negative factors of lingering uncertainties over the emerging markets following the US tapering, China's on-going structural reform and the weakening yen trend.

Import growth (BOP basis):
-3.2% in 2013 → 5.2% in
2014

Import growth is expected to recover and show an ascending trend, owing to base effect and to economic recovery at home and abroad, which is gradually becoming tangible. However, the rate at which it is growing is expected to hover above the rate of export growth, caused by falling cost due to downward stabilization of raw material prices, including crude oil prices.

Current account balance:
US\$79.9 billion surplus in
2013 → US\$76.7 billion in
2014

Despite a prolonged large-scale goods balance surplus, the size of deficit of services balance increased by small degree and is expected to cause a small nudge down in total current account surplus in 2014. As the import growth outpaces the export growth by a small margin due to downward stabilization of raw material costs, the goods balance in 2014 is expected to sustain a large level of surplus. Services balance is projected to maintain a negative growth trend, attributable to low productivity of the service industry at fundamental level, depreciation of foreign exchange rate and the weak yen.

Consumer prices: 1.3% in
2013 → 2.2% in 2014

The inflation rate is forecast to be limited in the low 2 percent range, following expectations that raw material costs and the USD/KRW rate will stay stabilized, the key variables affecting the domestic price fluctuation. However the low inflation rate trend is projected to short-live as appreciating pressure of public utility costs and improving demand is rising. The expected inflation rate is growing faster than that of the consumer prices and the GDP gap (demand pressure) has already turned around to be positive in early 2014.

Corporate bond yield (3-yr,
AA-): 3.2% in 2013 → 3.6%
in 2014

Global interest rates are expected to show a moderate but sustaining upward trend, affected by such upward pressure as the US Fed's tapering, domestic growth rate and consumer prices rate. Signs of recovery in the Eurozone and the global economy are slowly visible and will put upward pressure on global interest rates, which will prompt the domestic interest rate to rise as well.

Economic Trends and Outlook

USD/KRW: 1,095 won in 2013 → 1,068 won in 2014

USD/KRW is expected to fall due to won-appreciating factors such as sound level of foreign reserves in Korea; however, the rate at which it is dipping is mitigated by upward pressure such as downsizing of US quantitative easing and lingering uncertainties over the weakening yen. There is a heap of risks associated with exchange rate volatility, as uncertainties of emerging economies, which originated from tapering, may lead to a sudden capital outflows.

Outlook for Korean Economy in 2014

(Unit: %YoY, US\$100mil(Balance of Payment))

	2013	2014						
	Year	1Q	2Q	3Q	4Q	1H	2H	Year
GDP	3.0	3.6	3.6	3.6	3.3	3.6	3.4	3.5
(SA, QoQ%)		0.6	1.0	1.1	0.6	1.6	1.8	
Private consumption	2.0	2.9	2.8	2.4	2.5	2.9	2.5	2.6
Construction investment	6.7	4.5	1.3	1.3	3.8	2.6	2.6	2.6
Facilities investment	-1.5	6.6	5.6	4.7	5.4	6.1	5.1	5.6
Export(Goods and Services)	4.3	4.4	4.0	6.2	6.4	4.2	6.3	5.3
Import(Goods and Services)	1.6	5.8	6.4	8.3	6.7	6.1	7.5	6.8
Consumer prices	1.3	1.1	2.0	2.4	3.2	1.5	2.8	2.2
Current Account Balance	798.8	105.5	181.1	217.7	262.9	286.6	480.7	767.2
Goods Balance	805.7	139.7	189.2	223.9	271.6	328.9	495.5	824.4
Export(BOP base)	6,171.3	1,519.3	1,601.4	1,617.5	1,728.6	3,120.7	3,346.1	6,466.8
Growth rate%	2.3	3.4	4.0	5.2	6.4	3.7	5.8	4.8
Import(BOP base)	5,365.6	1,379.6	1,412.2	1,393.6	1,457.0	2,791.8	2,850.6	5,642.3
Growth rate%	-3.2	2.3	5.4	7.3	5.7	3.8	6.5	5.2
Service and Other balances*	-6.8	-34.2	-8.1	-6.2	-8.6	-42.3	-14.8	-57.2
FX rate(avg. won/dollar)	1,095.2	1,069.1	1,075.0	1,067.0	1,061.0	1,072.1	1,064.0	1,068.0
Corp. bond yield (3-yr, AA-)	3.2	3.3	3.6	3.7	3.9	3.5	3.8	3.6
Unemployment rate(%)	3.1	3.2	3.0	2.9	2.9	3.1	2.9	3.0
Employment level changes(000)	385.8	628.0	430.5	406.6	380.2	529.3	393.4	461.3

* Sum of service balance, primary balance, and secondary balance

Policy Issue:

Policy suggestions to invigorate medical tourism

(Research Background)
Vitalizing service business is critical in order to boost employments and promote economic growth, of which medical tourism is an important core

In the near future, medical services will globalize further as global demand is increasing and the national boundaries become increasingly meaningless in economic terms. Although the forecast stands in the Republic of Korea as well, globalization of the medical sector has been tardy due to the perceptions of Koreans that the medical services is a public sector which must not be damaged by corporate profits and that sector is limited to the domestic realm. At any rate, the globalization of medical services may enhance quality of the labor force, as the number of self-employed and unpaid workers constitutes a small portion while the regular, full-time workers are the majority in the medical services sector. Considering its advance level of surgical skills and price competitiveness, Korea's medical services sector poses great potential.

The globalization of medical tourism is estimated to induce production value of 11.6 trillion won in 2020 and create about 84,000 additional jobs to society

The production inducement is estimated to grow from 800 billion won in 2012 to 5.3 trillion won in 2017 and to 11.6 trillion won in 2020. The three-year annual average rates between 2010 and 2012 are used to calculate per capita medical cost (12.7%) and offshore patients (38.6%), respectively, assuming that the rates will maintain the annual average rate until 2015 and gradually slow down after 2015.

The job creation is estimated to expand from 39,000 jobs in 2017 to 84,000 in 2020. These numbers are 11.3% of the current total number of employees of the medical sector.

(Policy Implications) **In order to invigorate medical tourism the regulation that restricts securing international clientele and supply of medical services must be lifted**

First, regulatory reform is urgent to attract potential people on demand. We suggest amendment of the current medical law to allow medical tourism promotion and to treat and admit a wide range of international patients. For example, the medical advertisement in foreign language ought to be admitted at international airports and hotels. Also, international clients should be permitted to receive domestic insurance services. This will also provide a strong incentive for the domestic insurance companies to invest more in R&D and develop various insurance packages tailored to meet the demand of the international clientele, while enhancing its own global competitiveness.

At the same time, we suggest modification of the current regulations as well, so that the international clients may easily travel in and out of Korea. For example, the financial requirements for and process of issuing the medical tourism visa should be simplified. Administrative support should be provided to those who seek to convert their medical visa to other types of visa, such as no-visa entry or tourist visa. If clients or their accompanied family stay in a certain region of Korea only, no-visa entry should be allowed.

Second, regulations on the supply side must be lifted as well. In order to invigorate the research and development of medical services, the convergence of expertise is significant.

Items to be legalized are as follows:

- ✓ Permission of partnership between medical practitioners of western and Korean traditional medicine and between medical doctors and pharmacists
- ✓ Permission of opening branches of a medical hospital
- ✓ Permission of businesses of various alternative medical services suppliers, such as chiropractic therapists, acupuncturists, music and art therapists, and other alternative medicine providers
- ✓ Enhancing competitiveness by scaling up of medical services
- ✓ Lowering of the current cap of 50% of foreign capital ratio requirement, and employment duty ratio of hiring foreign doctors for foreign hospitals building in a free economic zone
- ✓ Repeal 5% ceiling of foreigner bed in domestic hospital in a free economic zone

Third, we suggest constructing 'Comprehensive, regulation-free medical tourism cluster' as a viable policy alternative to criticism over possible damage of "publicness" in medical tourism. The medical tourism should be treated separately from the other medical services; various regulations on medical tourism in the cluster should be abolished. In order to promote participation from domestic, as well as overseas hospitals, current regulations that limit the number of hospitals managed by a medical doctor and/or medical corporation should be lifted.

Even when certain investment can be allowed under current law, a heap of obstacles exists at the local government level that it is nearly impossible to carry out any meaningful investment. Thus, a negative list approach to medical investment should be introduced.

Meanwhile, selection of the cluster locations should be free from any political bias, and preferences of the foreign clientele should be taken into account. To encourage participation from families of the foreign clients, the no-visa entry to the cluster should be considered, while the cluster should be equipped with various hotels, recreational and leisure facilities so that patients and accompanied families can enjoy the amenities.

The estimation of economic value of medical tourism

(Unit: people, 100million Won)

		2012	2017	2020
The number of patients	Foreign patients	159,464	717,528	1,343,213
	Family accompanied	47,839	215,258	402,964
	Total	207,334	932,817	1,746,197
The revenue from medical service	Average medical cost per capita	167	269	320
	Medical profit	2,663	19,273	42,970
The revenue from tourism	Expenditure per capita	164	181	192
	Tourism profit	785	3,898	7,743
Total Revenue		3,448	23,170	50,713
Effect on production inducement	Medical service	5,913	42,796	95,417
	Tourism	2,077	10,318	20,497
	Total	7,990	53,114	115,914
Effect on value added inducement	Medical service	2,214	16,019	35,716
	Tourism	614	3,048	6,055
	Total	2,827	19,067	41,771
Effect on employment inducement	Medical service	3,728	26,982	60,158
	Tourism	2,416	12,005	23,849
	Total	6,145	38,986	84,006
Effect on labor inducement	Medical service	3,089	22,356	49,845
	Tourism	1,122	5,574	11,073
	Total	4,211	27,930	60,917

Note 1: Above was estimated by Korea Economic Research Institute using the Bank of Korea 'Input - Output 2010 extended Table', Ministry of Health and Welfare 'The report of foreign patients 2012', and Ministry of Culture, Sports, and Tourism, 'The real condition research of overseas tourist 2011'

Note 2: Foreign patient cost per capita was estimated excluding inflation rate, and with assumption that the cost growth be that of average between 2010 and 2012, 12.7%, considering growth of hospitalization and patients with advanced disease. The cost per capita of accompanied family was also estimated excluding inflation rate, and with the assumption that the growth of tourist expenditure per capital growing at 2%. Average foreign exchange rate used is US1\$ = 1,070won which was calculated from the 2014 KERI FX prediction of US1\$=1,068.

A Historical Review on the Ownership Structure and the Corporate Governance of Developed Countries

Research Monograph 13-07

Hyun Jong Kim

This study reviews how historical factors affect the ownership structure and the corporate governance of developed countries. From the starting points of the economic development, corporate governance had been affected by institutional system in the own country. This study provides a history of corporate governance in each country, beginning as early as necessarily explain how that country came to its current state. Inevitably, great mercantile families, politics, and institutional development interact. Despite business groups were already established earlier 20th, there was no agency problems between controlling shareholders and outside investors, because almost all affiliates of business groups were not listed that time. This policy incubated the agency problems between stockholders, but the corporate governance has not been seriously concerned, because the government worked as the guardian of the controlling shareholders of business groups.

Korea's Exports to China and Effects of Chinese RMB, Korean Won, and Japanese Yen Exchange Rates

Research Monograph 13-08

Chan-Guk Huh

This paper looks at the extent of the effects of China's real effective exchange rate (RMB REER) on Korea's exports to China in relation to the real bilateral exchange rate between the currencies of the two countries. Also examined is how the changes in Japanese Yen's exchange rate vis-avis Chinese RMB affect Korea's exports to China. The first issue has become important to Korea's overall economic performance as China has remained as the leading export destination for Korea since 2003, and approximately 1/4 of Korea's overall exports are headed that way. The second question is also meaningful due to the apparent effects of the so called 'Abenomics' launched in late 2012 on the exchange rates of the Yen. The cointegration method of Johansen was employed to estimate models of Korea's exports to China, using various exchange rates as well as trade data of Korea, China and Japan since the mid 1990s. Results show that the Abstract 113 RMB REER has far greater influence on Korea's China bound exports in comparison to the real bilateral exchange rate of Korean won and Chinese RMB. Another key finding is that the real Yen-RMB exchange rate has varying degree of positive effects on Korea's exports to China. That is, Korea's exports increase, rather than decrease when the Japanese Yen depreciates against RMB. This suggest that Korea's exports to China has a complementary relationship with those of Japan to China. These together with data on commodity compositions of Korea's exports to China suggest that Korean manufacturers of competitive intermediate goods already may have established supply chain relationship with Korean as well as 3rd country businesses operating in China.

An Analysis of the Supplier Performance - on the suppliers of 4 largest group affiliated firms -

Research Monograph 14-02

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In this study, we focused on the business relations between small suppliers and large buyers to examine how the buyer-supplier relationship affects small supplying companies. In particular, we focused on analyzing large business groups (Samsung, LG, SK, and Hyundai Motors) that are subject to the regulation. In the result of the analysis, we can see that the performance of buyers has a positive relationship with the performance of suppliers. With the exception of the gross profit margin, performance of buyers and performance of suppliers are moving in the same direction. It is unlikely that buyers are exploiting suppliers in order to improve their own performance and dropping the performance of suppliers.

The performance of buyers has a positive effect on suppliers, but suppliers could have been able to make more profit if it were not in a buyer-supplier relationship with large companies. In order to verify this, this paper compares the performance between the suppliers and non-suppliers. In the result of the study, suppliers' gross margin was significantly lower than comparing with the non-suppliers' gross margin and we were able to see that there was a discount occurring in the unit price of suppliers. On the other hand, profits that reflect other costs (such as operating profit and profit margin on sales) rather than cost of goods sold did not show any signs of under-performance of suppliers compared with non-suppliers. This can be interpreted as that suppliers could reduce SG&A costs, except for the costs of goods sold, in order to compensate for the loss in the gross profit margin. In the result, we were able to see that the final outcome, return on assets (ROA) and return on equity (ROE) of suppliers were significantly higher than non-suppliers.

To further investigate reasons why suppliers' ROA and ROE are higher than non-suppliers', we looked into companies' asset utilization. In the results of empirical analysis, we could see that the supplier's asset turnover rate was significantly higher than the non-supplier's. Higher asset turnover rate is interpreted as 'having the same amount of assets but causing more revenue'; therefore even though return on sales is lower, it is possible to make higher ROA and ROE according to the Dupont identity. In the result of analysis, except for ROA and ROE, we were not able to identify any differences in supplier's profit margin on sales compare to non-supplier's profit margin on sale. As we have expected, supplier's receivables turnover rate was higher, which implies that suppliers received bills rapidly from large companies compared with non-suppliers. The combination of shorter receivables and inventory conversion periods make suppliers to have shorter cash conversion cycles.

Finally, we analyzed the concentration effect of sales ratio of suppliers' to large companies. In the result, the sales concentration has a negative effect on the gross profit margin but has no significant effect on the operating profit margin or net profit margin. However, the sales concentration has a positive effect on ROA and ROE. Since the sales concentration does not have any effects on net profit margin, but has a positive effect on ROA, we can assume that the sales concentration has a positive effect on asset turnover of suppliers. Consistent with

the hypothesis, the sales concentration raises both turnover ratio of receivables and inventories of suppliers. In conclusion, the sales concentration also shortens cash conversion cycle of suppliers.

From these results, we are able to recognize that existing perception of the buyer-supplier relationship between the large companies and their suppliers is not entirely correct. Of course, large companies that disturb the market order and making unfair trading must be restricted and punished. However, in order to determine to what extent it should be considered as unfair trading, and in order to improve buyer-supplier partnership, we must consider an objective and accurate analysis of actual relationship between larger buyers and small suppliers.

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