

CHANGES IN KOREA'S CORPORATE ENVIRONMENT

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Despite the many factors of instability surrounding Korean companies in 2002, hopes for economic recovery are spreading. However, it is too early for optimism. Because of uncertain external factors, continued stimulus of domestic demand may be needed for the economy to get back on its growth path.

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Uncertain External Changes

The world IT market is one of the most important external factors affecting Korea's economy. Overcoming the excess supply and excess labor that have plagued the world IT sector will be a key to economic recovery. Although the rate of IT inventory reduction was not as high as the rate of new shipments, inventory fell at a faster rate in the fourth quarter, suggesting a recovery for next year. However, excess inventory and facility overcapacity are still problems in the IT sector in the US, while contracted IT demand continues and signs of a continuing economic slump are appearing. It is expected that the world economy will enter a recovery when the problem of IT overcapacity is resolved.

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Another important external factor is the war on terrorism. If the war spreads from Afghanistan to other terrorist-harboring states such as Somalia or Iraq, the world economy may fall into a quagmire, and Korean companies will not be able to avoid the fallout. In addition, because the effects of the September 11 attacks were barely reflected in Korea's third quarter's economic indicators, expectations of a recovery may be premature. Considering that Japan may experience negative growth next year, and the yen will weaken further, the price competitiveness of Korea's exports is expected to suffer. Another negative factor for Korea's exports is that many countries are trying to devalue their currencies to promote exports.

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Domestic Developments

In 2002, many events will affect the Korean economy. First, campaigning for the presidential election and regional elections are expected to have effects on the economy. In addition, it is forecast that international sporting events such as the 2002 World Cup and the Pusan Asian Games will stimulate the economy.

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One issue that cannot be ignored is the sale and merger of struggling Korean companies that are in negotiation. When the large companies under negotiation are finally sold or merged, a great burden will be removed from the Korean economy. In addition, the beleaguered semiconductor industry, which accounts for a large share of the economy, has seen a boost recently. Although the recent rise in semiconductor prices was temporary and due to seasonal factors, it is expected that a merger of Hynix Semiconductor with Micron Technologies will stabilize semiconductor prices and streamline the industry. The semiconductor industry will also be invigorated by improved marketing for PCs, as well as diversification of semiconductor demand.

Toward a Recovery

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The government and corporate sector need to play an active role in stimulating further investment. Although Korea's savings rate has always been high compared to those of advanced countries, it was only 27.8% in the third quarter, the lowest level in 15 years. The recent government measures to reduce consumption taxes have contributed to consumption by reducing prices, but they have also led to reduced savings rates, which will reduce the scope for future investment. The engines for domestic economic growth in 2001 were public and household consumption. It is difficult to expect an increase in household and corporate savings rates with the world economy in such an uncertain situation and real interest rates having fallen almost to zero. However, businesses and the government will need to adopt a longer-term approach and more far-sighted roles to invigorate investment and establish sound investment conditions and go beyond short-term and limited stimulus. According to recent surveys, most businesses predict that the economic slump will continue in early 2002, and are taking a conservative approach to investment in light of the probable lack of demand. It will be difficult to expect an active increase in facility investment as long as the problem of excess facility due to the economic slump is not resolved. That is why companies are focusing their investment into R&D efforts such as product development and new technology.

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Despite the numerous problems lingering in the business environment, the international community is viewing the post-IMF era Korea in a positive light. International credit ratings agencies such as Standard and Poor's and Moody's have upgraded Korea's sovereign credit rating by a notch. In addition, Korea's recent growth rate has been high compared to that of the US, Japan, and Europe, which are in recession, as well as other Asian countries such as Taiwan, Singapore, and Hong Kong, which saw negative growth in 2001. According to a BBC report, this was due to Korea's high growth potential relative to its neighboring countries. Meanwhile, Goldman Sachs speculates that Korea may have already passed the trough of its business cycle, pointing to third quarter growth that far exceeded forecasts. The Financial Times reported that foreign investors are viewing Korea as a safe spot in the current global slump, which has resulted in large capital inflows to Korea. In other words, the rapid inflow of foreign funds reflects Korea's relatively sound economic performance and its credibility in the eyes of foreign investors. **VIP**