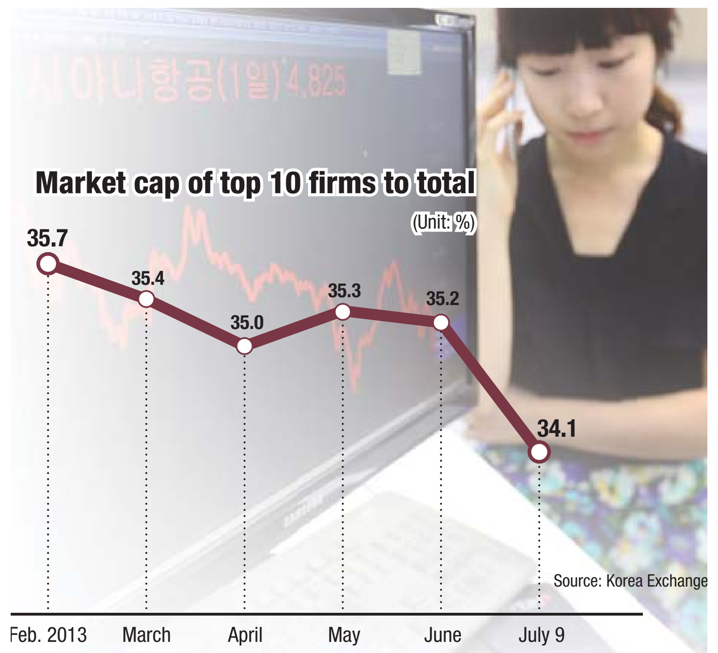
STAT WATCH



The top 10 listed firms have seen their combined share of the entire market capitalization decline this year as foreign investors dumped Samsung Electronics and other blue chips amid the increasingly uncertain global economic conditions, data showed Tuesday.

According to the Korea Exchange, operator of the nation's main bourse, the combined market cap of the top 10 firms stood at 404.3 trillion won ($351.2 billion) Tuesday. The figure represents 34.1 percent of the aggregate market cap, down 1.6 percentage points from 35.7 percent late February.

Samsung Electronics, the world's top smartphone maker, was the biggest loser as the company saw its market cap drop by 45 trillion won during the same period. The firm accounted for 15.8 percent of the market cap, down from 17.6 percent in February.

WINNERS & LOSERS

Hyundai Merchant Marine, Korea's second-largest shipping firm, said on Friday that it has inked a 208 billion won ($183 million) deal with Hanjin Heavy Industries, a Korean shipbuilder, to build four bulk carriers.

According to the firm, the new ships can transport cargo of up to 150,000 tons, and will be used for the transportation of coal for power generation from Canada and Australia to Korea. The vessels are scheduled to be delivered starting from 2015.

The shipping firm secured a 175 billion won deal to transport coal for local power plant firms last month.

The shipbuilder said the deal, which is the first in the last five years for the company, is expected to revitalize both the firm and the regional economy of Youngdo in Busan, where its shipbuilding yard is located.

Prosecutors arrested three incumbent and former executives of **Hyundai Heavy Industries**, a major Korean shipbuilder, Thursday, over bribery allegations related to a nuclear power plant corruption scandal.

According to the Busan District Prosecutor's Office, the three allegedly offered bribes to a senior employee of Korea Hydro & Nuclear Power (KHNP), operator of nuclear plants in Korea, in exchange for accepting nuclear plant parts manufactured by Hyundai.

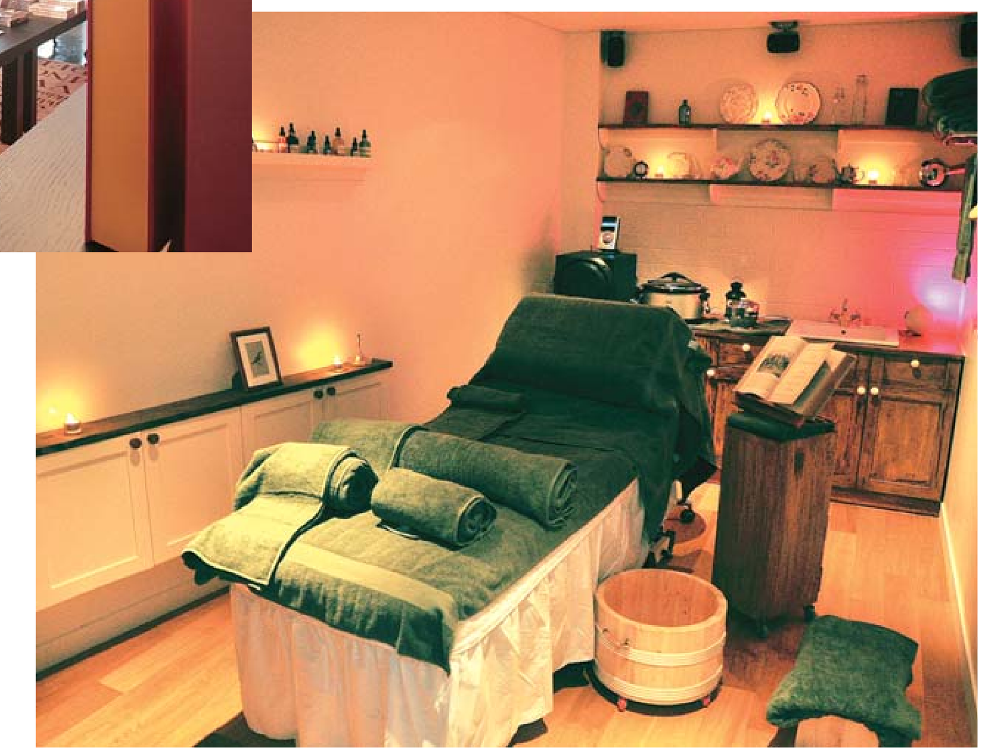
Authorities previously raided the company's headquarters in the southeastern port city of Ulsan, Wednesday, and arrested two senior managers on the same allegations.

KHNP has been under investigation because some of its senior employees turned a blind eye to manipulated test results of faulty cable parts and the use of such parts in domestic nuclear reactors.

PHOTO OF THE WEEK

Asiana apologizes Asiana Airlines CEO Yoon Young-doo bows in apology during a press conference at the company's headquarters in western Seoul, on July 7, for the crash of a passenger jet at San Francisco International Airport on July 6 (local time). Yonhap

Stores become 'brand experience' spaces



From left to right:
Nespresso Korea's flagship store in Cheongdam-dong, Seoul, has a separate tasting area where customers can try coffee made from the brand's capsules.

Cosmetics brand Innistfree Jeju House not only sells its products, it also offers various snacks and beverages made from local organic produce.

At Assouline Lounge, a local branch of the French luxury book publisher, customers can flip through fashion magazines as well as enjoy French cuisine at its cafe in Sinsa-dong, Seoul.

British cosmetics brand Lush operates a spa store in Apgujeong-dong, Seoul, where customers can experience its products during a relaxing spa session.

By Kim Bo-eun
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MARKETING

Companies are taking a new approach in reaching out to consumers. Conventionally, they promoted their products to consumers through commercials and advertisements. If these promotions managed to convince consumers, purchases would follow. Further, stores were places that merely assumed the role of sales.

However, they are now evolving to fulfill a more complex role with the aim of providing a compelling brand experience to those who visit. Stores now encourage customers to use or taste the products sold. Stores in themselves have become an important marketing tool by providing a much more interactive brand experience.

Regardless of the type of product, stores have become multi-functioning places that not only offer customers a great shopping experience but also provide them a space to relax, enjoy beverages and meals, admire works of art and be entertained. All of these additional activities are aligned with brand concepts, so they reinforce brand values. Whether customers are testing a coffee machine or sipping on a glass of champagne, everything that happens in the store represents the brand.

Maximizing brand experience

Nespresso Korea, the local branch of the Swiss food manufacturer Nestle's coffee brand, recently hosted a summer party at its flagship store in Cheongdam-dong. The hip and trendy event was designed so that coffee lovers could learn about coffee from experts, and make and enjoy iced coffee using Nespresso's coffee capsules and machines.

While the party was a seasonal event, Nespresso's flagship store provides a similar experience all year round. At the store, customers are not only able purchase the brand's products but also test its coffee makers and taste different types of coffee made from the coffee capsules.

The store helps the brand interact with customers by catering to their individual tastes on a membership basis. The flagship store plans to take a step further by opening a Nespresso Coffee Experience Center which will offer programs that will teach members about premium coffee.

Premium chocolate manufacturer Godiva opened a flagship store in the trendy district of Sinsa-dong, Seoul last December. Prior to the flagship store, it had opened a small store in Samsung-dong, southern Seoul, where only a handful of chocolate products were available. However, the flagship store not only offers a much wider assortment of the sweet delicacies for purchase, it also allows customers to sit and enjoy chocolate-based drinks and desserts in a posh cafe; on the second floor.

British cosmetics brand Lush has adopted a similar strategy to more effectively market its products. It opened its fourth spa store in Apgujeong-dong, Seoul, last October. The store, whose interior resembles that of a British cottage, enables customers to experience the brand's bath and beauty products during a relaxing spa session. Designed by product developers and psychotherapists, the session aims to provide a healing experience using music, lighting and Lush's products. Customers are provided a hot cup of tea with a drop of rum after the spa session.

Beyond shopping

The store evolution is changing the shopping experience. Rather than being quick stops where people buy and leave, they are becoming places where visitors can spend hours and perhaps even a whole day, because they have so much more to offer. Of course, these offerings are designed so that visitors can fully immerse themselves in the brand concept.

Innisfree, a brand of cosmetics maker AMOREPACIFIC, operates a shop on Jeju Island where customers can holistically experience the brand through all five senses.

In addition being able to purchase cosmetics products on display, customers can see and smell the naturally extracted colors and scents of the products. On one corner, customers can make soap bars using natural ingredients, and on another, they can sit and enjoy light meals and beverages made from local organic produce. The building, which has glass walls on all four sides, looks out to the vast green tea fields on the island, enhancing the eco-friendly ambience of the store. Every aspect of the store is designed to promote its image as an eco-friendly brand.

Bookstores have also evolved as multi-purpose spaces that maximize brand experience. Assouline Lounge, a local branch of the French luxury book publisher, provides this type of encounter. Last month, Assouline opened a boutique at Galleria Department Store in Apgujeong-dong, Seoul, in addition to its store in the neighboring Sinsa-dong area. At the boutique, visitors can leaf through fashion magazines with a glass of champagne in one hand. The lounge has a book gallery that stocks some 200 titles in design, fashion, architecture, lifestyle, travel and photography, which visitors can view and purchase. It also offers French cuisine and beverages at a cafe inside. The experience of browsing through luxury publications while enjoying French cuisine represents the upscale essence of the brand.

Last September, Cheil Industries, the textile and chemical unit of Samsung Group, opened Maison LEBEIGE, the flagship store for Cheil's women's clothing brand LEBEIGE. Together with the opening of the store, it launched a lifestyle line that reflects the simple but sophisticated values of LEBEIGE. The LEBEIGE store features furniture and home accessories in addition to its clothing line. It also exhibits works of art for visitors to view and hosts events such as mini concerts where customers can enjoy music, finger foods and drinks while shopping.

Expansion of cross-border real estate market by business partnership

By Choi Ja-ryoung

CONSULTING

Beginning in 2007, Korea's real estate market has seen a slowdown of transactions and prices. The market reacted sluggishly to manifold deregulation and revitalization policies that were imposed in the aftermath of global financial crisis.

The market recession is not part of a short-term economic fluctuation; rather, it is a signal that the Korean market is moving from a growth market to a mature one. Korea's real estate market has been a volume-oriented one driven by suppliers. It will, however, become geared towards a demand for buyers in the future, putting more weight on the quality of real estate assets.

The current market recession is, therefore, a process that leads to change. Real estate business models that involve institutional investors will flourish as Korea's institutional investors expand their investment in real estate assets.

Market players such as real estate developers and companies that own real estate assets will actively review and launch new businesses as part of their survival strategies under market depression. This will be the first year in which cross-border business models that entail business partnerships between real estate market players and players from other relevant industries begin to proliferate.

Real estate investors and investment returns

The Asian financial crisis of the late 90s initiated the opening of Korea's real estate market to foreign investors, thus expanding the real estate investment market in full-scale. Until the early 2000s, opportunist investors who targeted 10 to 12 percent return in their investment were the mainstream foreign investors in Korea.

Real estate fund was launched in 2003, and domestic investors, who emulated foreign investors' investment scheme, enjoyed 7 to 10 percent investment return as a result of indirect real estate investment. Shortly afterwards the investment return fell to 6 percent as investment capital accrued domestically and intensified investment competition.

Global financial crisis in the late 2000s triggered overseas real estate investment of Korea's institutional investors. The overseas investments are usually destined for core-type assets with high stability in countries such as the U.S., U.K., and so on. The percentage of Korean institutional investors' alternative investment will increase to over 20 percent from current 8 to 10 percent, enhancing the stature of Korean institutional investors in global real estate market in the future.

Office market

The office market in 2013 will see an overall downfall of investment return due to new large-scale developments and intensifying investment competition.

Korea's office market was established in the1970s and it has evolved around Central Business District (CBD) and Gangnam Business District (GBD). Office buildings constructed around the 70s have deteriorated over the past 20 years and lack adequate infrastructure. These office buildings now going under reconstruction and remodeling to generate relocation demand for prime-level office space, which in turn, is reducing vacancies in new office buildings built after 2010.

However, new additional supply of office space from Cheongjin 12 to 16 district in CBD, and IFC and the Federation of Korean Industries Hall in the Yeouido Business District (YBD) is expected to start an increase in office vacancies in Korea.

The indicators of office investment market are sale price and sales volume. Average sale price climbed over last year to approximately 4.3 million won per §³ after accumulated investment capital and scant investment targets inflamed the investment competition. Sales volume in office market is 5.6 trillion won, similar to last year's record. The sale price per area rose gradually since 2009, pushing down average investment return in office market from near 10 percent of the early 2000s to 6 percent. Korea's office market cannot support high investment returns as it did in the past, so will be change to long-term investments that target stable income gains.

Housing market

Korea's housing market began to slowdown in 2007, and both sale price and sales volume have declined since 2009. However, jeonsei prices have been climbing steeply while apartment condo prices have undergone a downturn. Strong jeonsei demand indicates a change of viewpoint in housing market consumers who used to think housing was an investment asset; they now regard it as a product for use.

Despite the changing attitudes of consumers, numerous issues still linger in the housing market. The unsold housing units that once exceeded 160,000 nationwide in the aftermath of global financial crisis has been cut significantly. Yet over 20,000 unsold housing units are still massed in metropolitan Seoul area. Moreover, the excessive number of unsold housing units is not holding back the number of government issued permit for new housing constructions. Approvals for 'urban living homes', the supply of which skyrocketed along with that of officetels recently to accommodate demand for low-cost housing, account for 24 percent of total approvals nationwide. The upsurge of low-cost housing supply in a short period has driven down the profit rate in housing lease market.

At the introduction of 'housing lease management business,' builders are creating new business departments that provide lease management service, despite continuing recession in housing market. They are expanding their past business model in which they only built and sold houses and apartment condos to the extent that they recruit potential buyers, operate, and manage facilities. Also, linkage and cooperation between a real estate management company and a company that owns real estate assets has resulted in increased development of company-owned rental housing. What we might expect from these changes in housing market are improved hardware of rental housing and upgraded quality service for residents.

Hotels

The number of foreign tourists in Korea recorded 10 million in 2012, growing by annual average of 10 percent since 2003. Chinese and Japanese tourists comprise 60 percent of total foreign tourists in Korea. Return visit ratio is high among Japanese tourists while many Chinese tourists choose Korea as their first overseas tourist destination. Recent trends have seen an increase in foreign tourists who visit Korea for their cultural interest including interest in K-pop. A shortage in supply of new hotel rooms vis-a-vis rising demand of foreign tourists brought about a boom in the domestic hotel market that lasted until 2012.

At present, 5-star and 4-star hotels account for 68 percent of hotels in Seoul. The average occupancy rate of these hotels is 80 percent, and the average room rate of 5-star hotels exhibited annual average growth of 8.6 percent during last 4 years. Responding to the current market environment, new supply plans for hotel rooms have piled up rapidly. As of today, the number of hotel rooms to be newly available by 2015 is about 15,000, 1.6 times the number of hotel rooms that became newly available in 2012. Conglomerate-affiliated hotels began to include economy hotel operations in their business portfolio; Hotel Shilla recently launched its business hotel brand Stay. Other than the traditional hotel operators, travel agencies including Hana Tour, Mode Tour, and JaU Tour have set out to develop like budget hotels, raising possibility of over-supply after 2015.

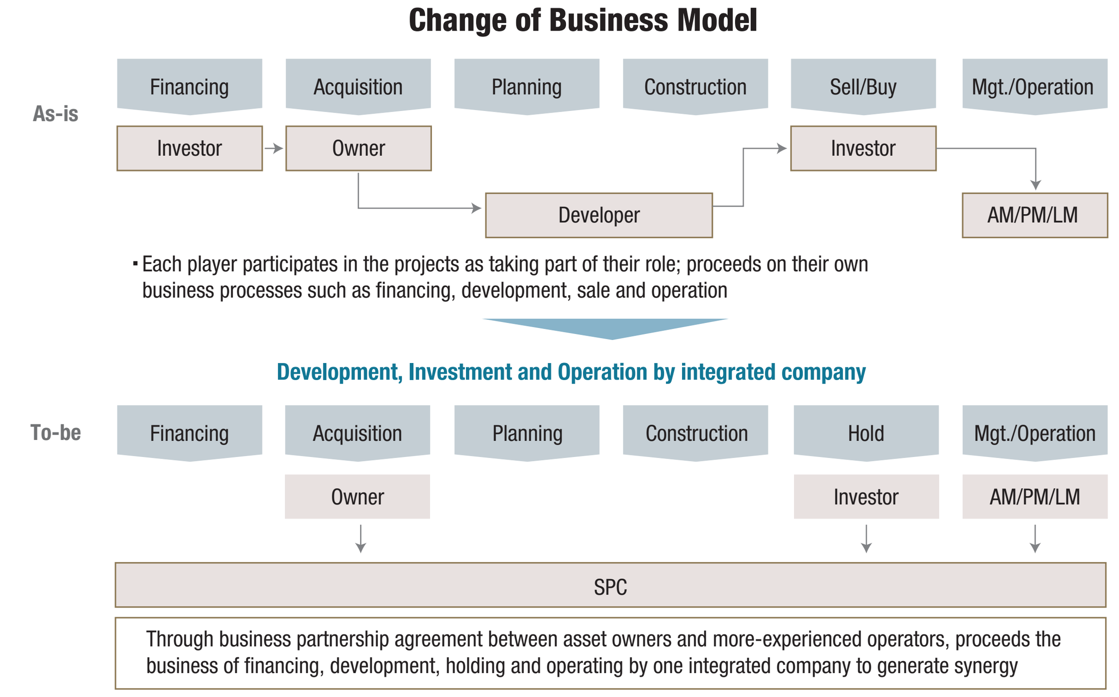
Korea's hotel business, however, is largely dependent on tourists' demand while tourists' demand depends on the exchange rate and market economy conditions. Tourists' demand entails high risk as it directly reflects changes in the market environment; the recent fall of the yen resulted in a sharp drop in Japanese tourists. Investment in hotel business requires prudent review rather than aggressive action.

Retail facilities and mixed-use development

Retail facilities in Korea have evolved through several stages starting in the 80s. With the introduction of department stores, retail facilities enlarged in size in the 80s; in the 90s, specialized retail facilities were introduced; and in the 2000s, mixed-use developments that encompass multiple functions including shopping and cultural activities under one roof have been developed.

Diversified needs of age-specific consumers have prompted bringing forward the mixed-use development in which customers may enjoy various leisure activities in a single commercial space such as Times Square, D-Cube City, Gimpo Sky Park, and IFC Mall. These mixed-use developments entail a business model in which facilities other than shopping mall — office, hotel, and residence — ensure the development's profitability, and differentiated functions such as lifestyle center and culture center attract customers, thus securing its competitiveness. The key success factors for the mixed-use developments are the quality of tenants and the know-how regarding operation and management. As in the case of FIT IN — developed and opened in Dongdaemun by Lotte Asset Development — the role of market players who specialize in developing and operating retail facilities will expand. Similar cases of shopping mall and mixed-use development will soon follow throughout the Korea market.

Change of Business Model



Korea's real estate market keywords 2013

In Korea, cross-border real estate market that involves inter-industry partnerships will expand in 2013. It has been a general trend in real estate business that a single market player proceed with the whole business process of financing, development, sales, operation, and management in a project. However, with growing business risk put upon a sole market player, real estate owners and their business partners who possess management know-how will increasingly sign business agreements that make way for effectuating mutual synergy by cooperating in financing, development, operation, and management of real estate assets.

In addition, a great number of future real estate projects will be subject to inter-industry and cross-border partnerships which may include undertaking M&A to expand business volume, and building joint enterprises. Due to real estate market recession, existing market players such as developers and construction companies are broadening their scope of business from construction to operation and management. Their recent movement will be accompanied by efforts to go beyond inter-industry borders and diversify business and profit models.

Package investments, partnerships, and joint investment will lead to sophistication of business subjects, method, and profit structure, which in turn will reinvigorate Korea's real estate market in recession. The changes in real estate business model will lay the ground for further ripening and sophistication of Korea's real estate market.

Choi Ja-ryoung is the head of construction and real estate business at Nomura Research Institute, Seoul.

SERI REPORT

Diagnosis of global and Korean economies

Over the past three years, the global economy experienced favorable growth in the first quarter followed by a sharp slowdown in the second quarter and an ensuing summer slowdown. The year 2013 also began with expectations of a global economic recovery starting in the U.S., but signs of a slowdown in the real economy have emerged along with financial instability.

Speculation is rife as to whether another summer slowdown will occur this year. Concerns about a global economic slowdown are heightening due to the U.S. January tax increase and March sequester, continued negative growth in the European economy, a slowdown in the Chinese economy and side effects from Japan's Abenomics. Concerns about a reduction in U.S. quantitative easing and signs of disappointment about Abenomics are amplifying financial instability.

The Korean economy had been regarded as an exemplary case of recovery from the global financial crisis, but recently concerns are growing as to whether this will continue. GDP growth remained at 0 percent quarter-on-quarter for the eighth straight quarter from second quarter 2011 through first quarter 2013. Various factors are weighing down the economy, including high household debt and a real estate market slump in Korea, U.S. fiscal problems, a recession in the European economy, the waning Japanese yen and a slowing Chinese economy. Consequently, major institutions have revised Korea's growth forecasts downward for 2013.

Korea's financial markets have also lost attractiveness, leading to a foreign capital outflow. Due to worries about the U.S. Federal Reserve's "tapering off" of quantitative easing, the KOSPI closed at 1,799 on June 24, falling below the 1,800 level for the first time in 11 months.

U.S. tapering of quantitative easing

Early this year, expectations for economic recovery were formed in the U.S. as households' financial status and consumption improved. Amid household deleveraging and falling interest rates, the ratio of debt payments to disposable income dropped to 10.5 percent in the first quarter of this year, sharply down from 14 percent in the third quarter of 2007. In addition, rising housing and stock prices led to an increase in assets at households, strengthening consumption conditions. As a result, despite tax hikes and sequestration, consumption grew 3.4 percent in the first quarter, above the GDP growth of 2.4 percent.

Based on expectations for economic recovery, the Fed said that it could start reducing quantitative easing toward the end of this year. Global financial markets reacted to the Fed's likely policy shift, with interest rates surging and stock markets plunging.

The timing of the U.S. shift in monetary policy is important in boosting economic recovery and stabilizing financial markets. With the underlying fundamentals of the private sector remaining weak, a sharp reduction in quantitative easing could lead to interest rate increases, causing the housing market recovery to slow and consumption and investment to shrink. However, if the markets are confident that the U.S. economy will show stable recovery, instability may be comparatively brief, and the policy shift will in the longer term support stable growth of the real economy.

Considering current U.S. economic conditions, the Fed's asset buying cuts could begin after the end of this year. It is expected to take a considerable time for the conditions for monetary policy change to mature. Treasury dealers in Wall Street say the unemployment rate should drop to below 7 percent and more than 200,000 new jobs should be added monthly over four to six months before the Fed can taper off its bond purchases. However, the U.S. jobless rate remains stuck in the 7 percent range. Fed Chairman Ben Bernanke has said that measures might be adjusted in response to economic conditions, and the U.S. could maintain its current policy stance if the economic recovery does not meet expectations.

Eurozone's shift from austerity to growth

In eurozone countries, conditions are the worst they have been since World War II. Fiscal austerity has led to a sharp contraction in the economy and a worsening job market. The eurozone economy contracted for the fifth straight quarter since the first quarter of 2012. The jobless rate hit a record 12.2 percent in April.

As a result, anti-government strikes against austerity measures are spreading, particularly in debt-stricken countries, while political and social uncertainties are heightening, including a rise in anti-German sentiment.

The eurozone is thus expected to shift its policy from tightening to growth, which will help ease the economic recession.

Japan's Abenomics effect

Abenomics has been successful in the short term. Share prices are surging and the yen is sharply depreciating against the U.S. dollar. Consumption sentiment is improving, and prospects for the Japanese economy are changing to a positive direction. In the second half of this year, the Abenomics effect will spread from the financial sector to the real economy, and Japanese economic growth will improve. However, whether Japan can escape its long downturn remains to be seen, due to rising long-term interest rates that could lead to asset losses at financial institutions, increased interest burdens on government bonds and a rise in inflation without a corresponding recovery.

Consumption-led growth in China

Faced with continued over-investment and an export slowdown since the global financial crisis, China is shifting from investment and export led growth to consumption-driven growth. The ratio of investment in GDP increased after the global financial crisis but its contribution to GDP has declined and export growth has slowed due to sluggish demand in advanced countries.

Consumption growth remains weak due to interest rate hikes in 2011 and an anti-corruption campaign in 2012. Yet the Chinese government's measures, including wage increases, urbanization and expansion in social welfare spending, a growing middle-income class and the emerging 1980s generation with high consumption propensities will enable a gradual shift to consumption-led development, which will likely prevent the country's growth from plunging.

This article was provided by the Samsung Economic Research Institute.