



The Emergence of a Mass Market and the Dynamics of Retail Forms in Korea

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In this paper, I examine the evolution of major retail forms—supermarkets, department stores, discount stores, and convenience stores—in Korea during three phases from the 1970s to the 1990s. Korea provides a useful comparison to Japan, showing how two nations subject to similar pressures from mass markets have experienced difficult structural and operational changes within retailing. Particular emphasis is given to changing markets and competition among retail forms and the relation of those factors to operating systems. I find that, although the dynamics of retail change in later developed countries create similar innovations in retail forms, plural paths of adaptation occur across national boundaries because of differences in markets, competition, and operating systems.

Economic development in Korea radically changed the forms of retailing in the country within a short period. The rapid economic growth not only boosted production but also increased private spending, causing a boom in consumption. Taking advantage of this business opportunity, a modern type of retailing, different from traditional forms, has emerged recently and has itself become a factor in maintaining economic growth.

Research focusing on spending patterns and on distribution (a channel that connects spending and production) is necessary to understand the process of Korean economic development. Yet much of the research to date has approached the subject from the production side and has neglected consumption. This could be the result of considering demand only in the export market while overlooking demand in the domestic

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market as the driving force of Korean economic development.¹ As a later developed country, Korea still lacks clear answers to questions concerning the outcome of economic growth, changes in consumers' needs, the effect of those changes on the structure of distribution and business transactions, and the transformation of retail forms deriving from those changes. How retail innovations occurred and how they penetrated into Korean society are questions that still need to be addressed.

In early developed countries, consumers have been provided with many different choices, and there are thriving experiments in retail forms and attempts to find answers to questions about the appearance and decline of various retail structures.² Explaining these dynamics is an important theme in the study of the retailing business. Previous studies have attempted to analyze various factors that influence changes in retail forms: innovation in competitive price and service, competition between retailers, socio-economic factors, and so forth. These are essential elements in studying retail forms in Korea as well, but theories based on experiences in early developed countries are inadequate as a tool to analyze and to clarify changes in retail forms that occur in a later developed country like Korea.³ Furthermore, later developed countries may take advantage of technology and knowledge systems already devised by the early developed countries and thus save the time and money put into the initial phase of the process. The shorter time period in which change occurs may produce patterns different from those in the early developed countries.

An exemplary case is presented by Japan, where rapid economic development gave birth to a mass market after World War II. To cope with the changes, Japan adopted new forms of retailing from the United States and Europe and modified them into Japanese retail forms. In the 1960s, a phenomenon dubbed a "distribution revolution" appeared, and Japan created its own retail forms, different from those in the West.⁴

Although there is a time gap between events in the two countries, looking at how transformations of retail forms occurred in Japan is useful, because Korea followed a similar catch-up developmental pattern. As later developed countries, did Korea and Japan behave similarly in introducing modern retail forms?

¹ Korea Chamber of Commerce, "Hankuke yutong sanop" [The Korean Distribution Industry] (Seoul, 1985). KDI, "Hankuke yutong sanop" [The Korean Distribution Industry] (Seoul, 1992). Takashi Okubo, "Kankoku no ryutsusanngyo" [The Korean Distribution Industry] (Tokyo, 1992).

² Richard S. Tedlow, *New and Improved* (New York, 1990); Richard S. Tedlow and Geoffrey Jones, eds., *The Rise and Fall of Mass Marketing* (New York, 1993).

³ Akira Hirose, "Kyachiappugata kogyokaron" [The study of catch-up style industrialization] (Nagoya, 2000), 5.

⁴ Kazutoshi Maeda, "Ryutu" [Distribution], in *Sengo Nihon Keizaishi* [The Japanese Economic History since 1945], ed. Shin'ichi Yonekawa et al. (Tokyo, 1990); Mariko Tatsuki, "Ryohanten no keieisojo" [The business creation of GMS], in *Kakusin No Keieisi* [The Business History of Innovation], ed. Tsunehiko Yui and Juro Hashimoto (Tokyo, 1995); Takeo Kikkawa and Mika Takaoka, "Supa maketto sistem no kokkusai iten to nihonteki henyō" [The international transfer and japanized adaptation of supermarket], in *Kokusai hikaku kokusaikankei no keieisi* [The Business History of International Relations and Comparison], ed. Hidemasa Morikawa and Tsunehiko Yui (Nagoya, 1997).

Research Method

To define the process of retail innovation, I used two indices, gross sales profit and product turnover rate, as axes to position retail forms and to examine their change in direction.⁵ I analyzed how each of the new forms of retailing achieved its margin and product turnover.⁶ I took this approach because, by changing the combination of gross sales profit and product turnover rate, we can trace the process of change in retail forms. In addition, these two axes are influenced by price decisions, product lines, location and number of stores, distribution management, and other operating systems that each retailer chooses. Changes in operating systems act as the impetus for retail innovation.

My analysis shows that retail forms evolved continuously over time, and that the evolution can be divided into three phases. In the first phase, retail forms started with a combination of low margins and low turnover rates; the second phase yields high margins and low turnover rates, and the last phase focuses primarily on high turnover rates. I examine in detail the mechanism of the transformation of major retail forms—supermarkets, department stores, discount stores, and convenience stores—that evolved in Korea in three phases from the 1970s to the 1990s (see Figure 1). I use this analysis to determine how retail forms observed in Korea differ from those in early developed countries.

FIGURE 1 The Development of Retail Forms in Korea

| Margin \ Turnover | Low | High |
|-------------------|---|---|
| High | Discount Store Convenience Store (3rd Phase) | |
| Low | Supermarket (1st Phase) | Department Store (2nd Phase) |

For the case of Japan, I made the following hypothesis: “Not only retail innovations adopted from foreign countries but also interdependence between manufacturers and retailers bring about unique changes to the retail forms in later developed countries.” By extending this hypothesis and applying it to the case of Korea, I can construct a more precise description of the innovations in retail forms in later developed countries.

⁵ Product turnover rate is calculated by dividing sales by average inventory.

⁶ J. Barry Mason and Morris L. Mayer, *Modern Retailing: Theory and Practice*, 5th ed. rev. (Homewood, Ill. , 1990), 12-13.

I addressed the issue of the transformation of retail forms by using historical analysis and, when possible, functional analysis, employing a variety of sources from the industry, individual companies, and the relevant literature; I also conducted interviews when appropriate.

Research Questions

The research questions were:

- During the emergence and growth of new retail forms, what kind of changes did the Korean market undergo?
- Who took charge of manufacturing and wholesaling and how did production procedures and trading terms change?
- What policies concerning retailing services did the government, which plays a leading role in a later developed country like Korea, put into effect?
- What are the competitive relations between the newly introduced retail forms and their existing counterparts?
- What competition arose from the increase in consumers' recognition of store brands, even within identical retail forms?
- How did the retailers' independent actions build unique operating procedures?

Research Results

Comparing the results of the research on Korea to those of early developed countries allows us to arrive at several significant conclusions concerning the changing procedures of retail forms in later developed countries.

First, consumers' changing needs directly affected the emergence of new retail forms. Until the 1970s, the needs of consumers were simply the products. In the mid-1980s, however, consumers became more attuned to brand values; and after the 1990s, consumers pursued better services such as low prices and convenience. As retailers responded to these changing needs and desires, new types of retail services emerged from traditional markets, in the following order: supermarkets, department stores, discount stores, and convenience stores.

Second, changes in the size and processes of manufacturers and wholesalers transformed retailers' purchasing and trading terms. These changes, in turn, significantly influenced what retail forms were adopted from abroad. If consumers' needs were a necessary condition, changes in manufacturers and retailers can be seen as a sufficient condition for the emergence of new retail forms. Manufacturers, who adopted a dominant marketing strategy until the 1980s, responded to major retailers' price bargains for the first time and consented to discounts for purchases in bulk. Supermarkets before the 1990s had no direct transactions with manufacturers. Even in department stores, transactions were confined to specific purchases.⁷ However, discount stores and convenience stores emerging in the 1990s adopted a direct purchasing route and brought about a new social phenomenon called "price destruction."

⁷ Department stores could return unsold goods and so were "selling on consignment."

Third, changes in government policies and intentions affected the formation and progress of new retail forms. In Korea, the government exercised its authority to hasten the adoption of production technologies and social systems established by early developed countries. The government spearheaded the introduction of new retail forms by establishing distribution policies and providing incentives for their adoption. Until the 1980s, the government's distribution policy consisted of selecting potential retailers. Since the 1990s, however, the government has suggested timelines for the liberalization of the distribution market for supermarkets and department stores and has encouraged discount and convenience stores to make decisions voluntarily that are in line with government policies.⁸ As the government's distribution policy had a signaling effect, especially to the discount and convenience stores, it brought about positive changes in domestic retailing companies, which pursued an activist management style and tried not to fall behind foreign companies.

Fourth, retail forms could gain superiority over existing practices by changing the rules of competition. Product line and store location are pivotal elements in competing with other retailers. If new retail forms take the same product lines and store locations as the pre-existing retailers, competition will become intense. To overcome this problem, new retailers tried to alter those two factors. Korean downtown department stores totally changed both, whereas their suburban counterparts changed only a bit, and discount stores drastically changed location. Moreover, when retail forms change product line and location, they have to adopt new operating procedures to deal with the new circumstances. Typical examples are one-stop shopping services by department stores and low pricing by discount stores. It is often not feasible for traditional retailers to employ these new processes. Finally, as is the case with convenience stores, there are times when superiority in competition can be achieved without changing product line or location. This is the "third method," which, by establishing a sophisticated logistics system and a "just in time" (JIT) management system, minimizes waste and loss and accelerates delivery speed.

Fifth, new retailers could gain a competitive advantage by developing a unique strategy in the process of becoming established. Initially, managers of supermarkets and department stores did not behave differently from similar retailers in terms of product display and store openings and therefore had no competitive advantage. However, Korean retailers, observing foreign retailers such as Wal-Mart and Carrefour, entered the discount store business and developed innovative methods. In order to distinguish themselves from other retailers, they adopted their own product lines and location strategies. This affected their profits and financial status and brought a clear division between successful and unsuccessful retailers, even among those of the same type. Fierce competition developed among convenience stores, and for a decade after their entry into the market, there was intense merger activity within this sector. As a result, the top three retailers took a greater percentage of the

⁸ The main laws on retailing and distribution have been changed three times since the Korean War, as follows; Sijan Law (Market Law), 1961; Dosomeup Jinhun Law (Wholesale and Retailing Promotion Law), 1986; and Yutongsaup Palchon Law (Distribution Development Law), 1997.

market share—each appropriated 25-30 percent of gross sales profits, though they differed in net profit.⁹

Sixth, new retail forms tried to build unique operating processes to yield higher margins and turnover rates. They implemented innovative processes in purchasing, selling, and logistics and changed product lines and location to differentiate their method of competition from other retailers. For example, discount stores established the system of low margins and high turnover rates, distinct from department stores. Not only did they lower the margin rates to sell low-priced products, but they also developed a low-cost operating system. Discount businesses implemented unique strategies to reduce costs: in products, purchasing in bulk and developing private brand products; in selling, self-service and cash sales; in store management, fewer employees, minimal interiors, and temporary workers. In addition, they established an efficient stock-tracking system. From fresh groceries to durable goods, logistics centers delivered products from manufacturers to the stores. By minimizing inventories and delivery lead time, they improved product turnover rates.

Conclusions

Korea's retail industry continued to innovate in its relations with consumers, producers, the government, and competitors, the key components of the market. In the process, the industry changed turnover rates and product margins. It is important to note, moreover, that the innovations evolved to improve the turnover rates consistently throughout the three phases. Furthermore, the strategies that retail companies adopted played a key role in increasing the sophistication of retail innovation.

Korean retailers differed from those in early developed countries in several ways:

- The short time span of retail innovation;
- Development of a new kind of retail industry by the conglomerates (*chebol*);
- Introduction of innovations from world-class retailers such as Wal-Mart, Carrefour, and Tesco;
- Government's relaxed regulation and competition policies;
- Less development of wholesalers and of manufacturer-led distribution routes; and
- Simultaneous emergence of modern retail forms based on information technology (IT).

The innovations adopted by the retail industry in Korea were influenced by the country's position as a later developed country, enabling retailers to adapt methods from abroad and requiring them to deal with changes in Korean consumers' needs. The industry also experienced unique changes resulting from the dynamics between manufacturers and retailers.

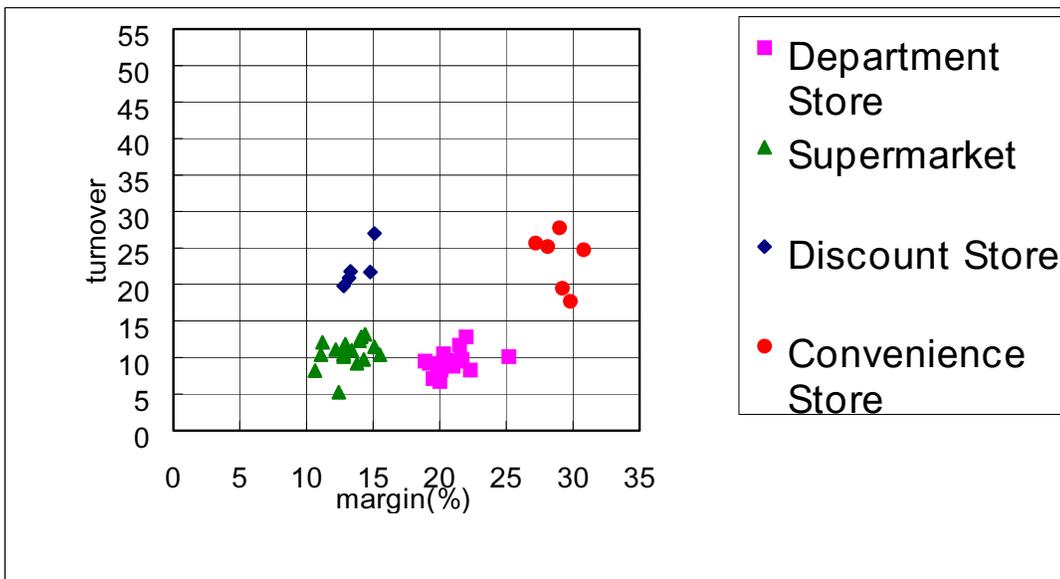
In Korea discount stores and convenience stores emerged almost at the same time, but in Japan discount stores preceded convenience outlets. There was a time lag between the period when superstores developed from the chains, enabling large-scale purchasers to stand up against manufacturers by taking advantage of large purchase and sales volumes, and the

⁹ Securities reports for three convenience store companies (Korea Seven, Bokwang, and LG Distribution) were used in this analysis.

period when convenience stores began taking advantage of IT, depending on information about consumers and products. In Korea, however, retailers secured the two bargaining tools—high trade volumes and the ability to collect data—to use against manufacturers almost at the same time. In Korea, wholesalers were not widely successful, and manufacturers’ dominant marketing position was more secure there than in Japan. I was therefore hard for retailers to strengthen their buying power against manufacturers just by increasing trade volume. In Japan, the wholesale industry developed earlier, giving retailers the advantage of that mechanism. This, in turn, resulted in favorable trade for wholesalers other than with manufacturers. Just by increasing trade volumes for retail chains and bigger shops, retailers were competitive against wholesalers. In Korea, however, manufacturer-led distributors dominated the distribution chain from manufacturers to retailers, so retailers had to make purchases through a manufacturer-led distribution channel.

To compete with powerful manufacturers, Korean retailers were required to increase their trade volumes by operating chain shops and large-scale shops. But it was also necessary to increase their efforts to organize and analyze data on production and consumption. Korea first acquired data management expertise in the 1990s when there was a worldwide IT boom. The Korean government was active in establishing an information-related infrastructure. As a result, discount stores and convenience stores adopted IT-led management systems and logistics as their main retailing advantage and went through rapid growth almost simultaneously. The two forms that recorded high product turnover rates of 25 came to have countervailing powers against manufacturers, which is unprecedented in Korea (see Figure 2).

FIGURE 2 Positioning Map by Retailing Forms



Source: Korea Chamber of Commerce, “Someup kyonyong dong te chosa pobo [The Report on Retailing Business] (Seoul, 1980-2000).

In the United States, innovation was initiated by retail forms like department stores and supermarkets as a means of increasing trade volumes against manufacturers. Superstores in more recently developed countries like Japan had the power to combine retail innovations. In the case of Korea, unprecedented countervailing retailing power against manufacturers came about by combining the buying power of chains and large-scale shops with retail innovations derived from the use of information technology.

For later developed countries, it was advantageous to learn and adopt retail innovation from advanced countries in a short period. Indeed, the rate for such innovations to take hold is determined by the power shift between manufacturers and retailers. In particular, whether or not wholesalers develop determines the power of retailers against manufacturers. For later developed countries where pre-existing distribution systems remained, there were two different patterns of innovation: in Korea, retailers strongly opposed the distribution channels led by manufacturers; in Japan, retailers strategically used the wholesalers' distribution channels.