

Korean Showbiz Cluster



Photo credit: Cheng Hang Teo

Microeconomics of Competitiveness

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1. Executive Summary

Korea has succeeded in transforming itself from one of the poorest countries in the world to a thriving developed economy over the span of just a few decades. Currently, it enjoys one of the highest growth rates within the OECD, low unemployment, and a well-educated labor force. It also faces some challenges in order to successfully maintain and increase its global competitiveness, however; transitioning to a “creative” economy; improving access to capital for smaller firms; and reducing the continued pre-eminence of the *chaebols* (large conglomerates), which reduces competition with new entrants and has led to concern about growing inequalities within the country.

Many of these successes and challenges are reflected in one of Korea’s most intriguing new clusters, the showbiz cluster. This cluster consists of the three industries tied together by mutual provision of services, as well as shared human resources, customers and supporting institutions: music, movies and TV dramas. It has seen rapid development since the late 1990s, due to a combination of factors, including decreased government regulation and a renewed focus on exporting to overseas markets after the Asian Financial Crisis.

With combined exports of over \$400 million, as well as widespread positive spillover effects to other parts of the national economy, this cluster has started to make a meaningful impact on the Korean economy as a whole. At the same time, it needs to make changes of its own, including increased competition with new entrants to encourage continued innovation; better collaboration with overseas partners to reduce dependence on the domestic and Asian (especially Japanese) market; encouraging private firms to increase financing available to SMEs; less involvement by the government and a greater role for the private sector in setting strategy; and investigation of alleged industry malpractices that threaten the health and reputation of the cluster.

By addressing the challenges at both the national and cluster level, we believe that Korea has a chance to further develop its showbiz cluster as a concrete example of its transition to a prosperous and competitive creative, innovation-based economy that can continue to provide better living standards for its citizens in the midst of increasing global competition.

2. Country Analysis: Republic of Korea¹

2.1 Overview

Located in Northeast Asia, on the southern half of the Korean peninsula, South Korea shares a land border with North Korea, while China, Japan, and Russia are close neighbors. Korea is the sixth most densely populated country in the world. Its 50 million people (2011) inhabit a 99,538 sq.km land area at an 80 percent urbanization rate. The capital city, Seoul, is the center of business, government and culture, and hosts one-quarter of the population.

Korean is the official language; English ability is better than in many other Asian countries, such as China and Japan (ETS 2013). The literacy rate is among the world's highest, at 97.9% of the population aged 15 and over (CIA, 2002). With centuries of ties with China and Japan, Korean value, such as hard work, family, and education were influenced by Confucianism. Korea is a resource-poor country (Sachs and Warner, 1997), although with some coal, tungsten, graphite, molybdenum, and lead.

Korea's geography impacted its historical development. In the late 19th century, as a small country among influential neighbors, Korea was a site of geopolitical struggle. It became the site of two wars: between Japan and China (1894-1895) and between Japan and Russia (1904-1905). From 1910 to 1945, Korea became a colony of Japan. After World War II, Korea was partitioned into a Soviet-aligned North and a U.S.-backed South, which squared off in the Korean War in 1950-1953. The war ended in an armistice, which remains in effect, so that North and South Korea are still technically at war. Korea has maintained a close alliance with the U.S. and hosts 28,500 U.S. troops. Today, Korea benefits from its geographic location, which facilitates trade with China and Japan.²

In the 1990s, Korea's military dictatorship ended and the country became a democracy. Its president is directly elected to a single five-year term and appoints the prime minister and cabinet. A unicameral National Assembly is elected every four years. Park Geun-hye of the Saenuri Party became President in February 2013.

¹ Throughout this report, we will refer to the Republic of Korea as simply "Korea", except where differentiation is necessary with the Democratic People's Republic of Korea (North Korea).

² <http://www.pbs.org/wgbh/pages/frontline/shows/kim/them/historical.html>

2.2 History of Economic Development

At the end of the Korean War, Korea was among the poorest countries in the world. The Korean government pursued an import-substitution route to industrialization, which later proved unsuccessful (Myung Soo Cha, 2010). In the 1960s, the government switched to an export-orientated strategy focused on heavy and chemical industries and the country began to rapidly industrialize. In the 1970s, it returned to an import-substitution industrialization model, causing a decline in growth and the strengthening of *chaebols* (large, family-owned conglomerates with close links to the government). In the 1980s, the government played an important role in fueling economic growth by deregulating trade and the financial sector, promoting exports, encouraging the manufacturing sector to use the latest technologies, investing in physical infrastructure, and improving the labor force's education standards and skills levels (Myung Soo Cha, 2010). In the 1990s, Korea became an affluent nation, joining the OECD in 1996. From 1980 to 1996, Korea had a strong GDP growth of 9% per annum.

Korea was hit hard by the 1997-98 Asian Financial Crisis. Private firms had borrowed excessively in foreign currencies and massively over-invested, especially in construction. The crisis led to several major financial sector and corporate reforms (Daphne Ho, 2006). Private sector investment has since become more cautious. In 1999, the economy rebounded strongly with a 10.5% GDP growth. The GDP growth rate has since stabilized at around 3~5% annually (World Bank, 2013). In the 2008-2009 financial crisis, Korea's exports dropped but the country maintained positive growth in 2008 and 2009 due to timely stimulus measures and strong domestic consumption.

2.3 Recent Economic Performance

In 2011, Korea's real GDP growth of 3.6% exceeded the OECD's 1.8% average and was the third-highest GDP growth among developed countries. Unemployment was low and stable at 3.4%, compared to 8% in the OECD; inflation was at 4.1%. The government maintained a small fiscal surplus, and public debt was low compared to its peers at 36.1 % of GDP. The Bank of Korea closely monitors exchange rates to maintain an "appropriate" level (OECD, 2013).

Korea's economic growth has been stronger than that of other developed nations, at 3~5% since the 1997 Asian Financial Crisis, significantly exceeding the OECD's 2% average, while its GDP per

capita of \$30,253 (current prices at PPP) is slightly below the OECD average (Figure 1). Compared to most other OECD economies, Korea relies heavily on international trade. In 2011, Korea's exports of goods and services accounted for 56.2% of GDP, while imports represented 54.1% of GDP (OECD, 2013). The country's main trading partners are China, the U.S., EU, Japan, and Hong Kong; key exports were in manufactured goods (Figure 2). Imports of finished goods are relatively low, as consumers prefer buying locally-made products (Oxford Economics, 2013).

Figure 1: GDP per capita & real GDP Growth, Korea and the OECD average

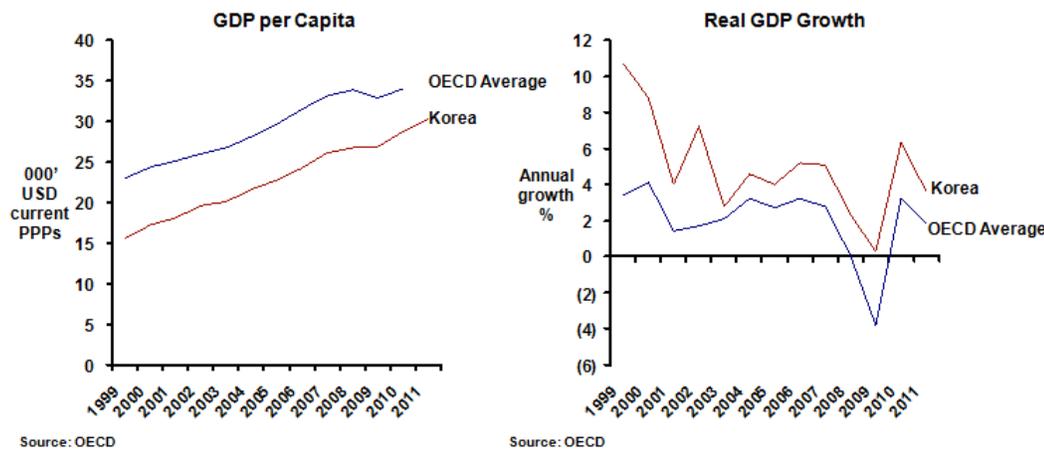
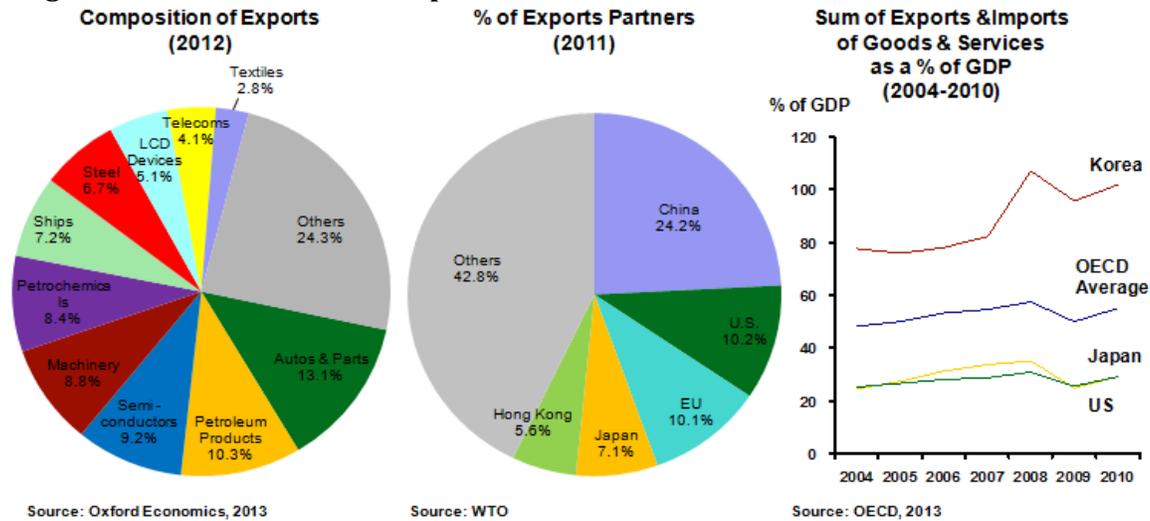


Figure 2: Overview of Korean exports



Korea is becoming an important international investor. Foreign direct investment outflow of \$20,355 million (or 1.8% of GDP) was 4 times larger than the attracted inflow of 4,660.5 million (or 0.4% of GDP). Negative reaction towards acquisitions of Korean firms by foreign investors and restrictions on inward investment in the service sector restrict FDI inflows. In 2011, Korea's outward

direct investment stock reached \$160.6 billion, while inward direct investment stock was \$ 135.7 billion (OECD, 2013; Oxford Economics, 2013).

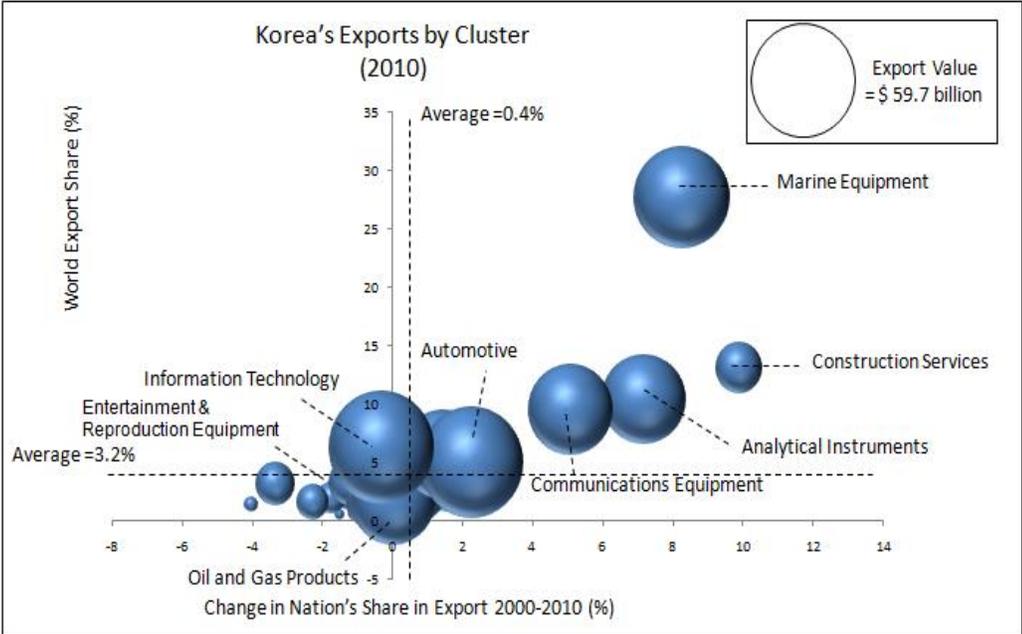
Labor productivity, measured as GDP per hour worked, at \$28.30, was low compared to the OECD average, of \$44.10. However, labor productivity growth is the highest in the OECD (OECD, 2013). In 2011 Korea ranked 4th in the world for the highest number of patent applications and the number of patents granted (WIPO, 2012). The economy is fueled by a well-educated young workforce. 65% of young Korea people aged 25-34 graduate from tertiary education, the highest percentage among OECD members. In addition, Korea’s private sector spending on education is also the highest (OECD, 2013).

2.4 Cluster Composition

In 2011, the Korean economy consisted of 60.2% of GDP coming from services, mining and utilities, 31.2% from manufacturing, 5.9% from construction, and 2.7% from agriculture (including fishing) (Oxford Economics, 2013).

In terms of exports, manufacturing clusters outperformed services clusters. The top five Korean exporting clusters in 2010 were information technology, with an export value of \$59.7 billion, automotive (\$58.0 billion), marine equipment (\$49.1 billion), communications equipment (\$38.4 billion), and transportation and logistics (\$38.0 billion). From 2000 to 2010, the top five clusters that increased

Figure 3: Korea's export portfolio by cluster



Source: Institute for Strategy and Competitiveness, 2013

their share of world export, suggesting growing competitiveness, were construction services, marine equipment, analytical instruments, communications equipment, and automotive (Figure 3). By comparison to

these clusters, the showbiz cluster is relatively small, with a recorded export value of a little more than \$400 million in 2011, although growth rates are high.³

2.5 Assessment of Macroeconomic Competitiveness

Overall, Korea has sound fiscal and monetary policies, a high level of human development, and more serious challenges in political institutions and rule of law.

Since recovering from the 1997 Asian Financial Crisis, the Korean government has maintained a prudent fiscal policy. It is among the few non-oil-exporting governments that run a budget surplus. Government debt stands at a healthy level of 34% and sovereign rating has been upgraded to AA-recently (Standard & Poor's, 2013). In terms of monetary policy, the Bank of Korea has been carefully balancing between economic growth and inflation. It currently targets a CPI range of 3.0% ±0.5% (Bank of Korea, 2012).

Korea has advanced healthcare and basic education systems. Life expectancy is 81 years, among the world's highest. Quality of primary education ranks 14th globally, with an enrollment rate of 98.6% (World Economic Forum, 2012). Overall, Korea's human development index stands at No.12 according to UNDP's 2013 assessment report, similar to Japan and Canada.

Korea's political institutions have drawn criticism in terms of both efficiency and equality. The country faces challenges that are common among new democracies. The public has little trust in politicians because of prevalence of favoritism (89th among 144 countries), wasteful government spending (107th), burden of excessive regulations (114th), and lack of transparency in policy making (133rd) (WEF, 2012). Problems regarding media censorship and freedom of speech happen occasionally (Reporters Without Borders, 2011).

Korea's rule of law performance lags behind its income position relative to other countries. Property rights and IP protection rank 52nd and 40th, respectively. Its judiciary is perceived to be inefficient in settling disputes (80th) and unwilling to challenge government regulations (96th) (WEF, 2012).

³ The showbiz cluster cannot be shown in Figure 3 due to the unavailability of global data on showbiz exports.

2.6 Assessment of the National Business Environment

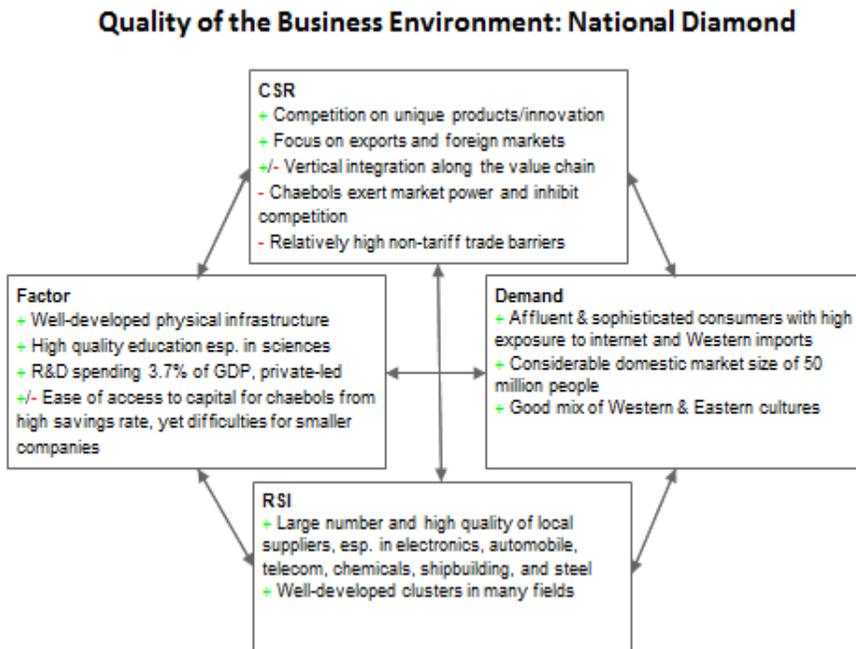
Korea ranked 19th in the Global Competitiveness Report 2012-2013, up from 24th in 2011-2012. This is impressive considering its GDP per capita ranking of 35th. Overall, Korea has strong demand conditions and related/supporting industries, while aspects such as factor conditions and context for strategy and rivalry show more mixed performance (Figure 4).

Demand Conditions

In general, Korean consumers exhibit relatively sophisticated demand. Within Asia, their income per capita ranks behind only Singapore, Japan, and Hong Kong. In addition to affluence, high exposure to the Internet (ranking 11th globally and comparable to Switzerland and Canada) further helps Koreans increase their knowledge and ability to compare specific performance attributes of products and services. According to the World Economic Forum’s ranking of buyer sophistication, Korea ranked 22nd globally, which is similar to developed economies such as Norway (21st) and Ireland (23rd).

In terms of market size, Korea’s 50 million people provide a considerable domestic market, which is sufficient for nearly all industries to achieve basic economies of scale. However for more ambitious

Figure 4: Korea's national diamond



enterprises, it is nearly impossible to reach the Fortune 500 list by predominantly focusing on domestic demand, as many Japanese and Chinese companies do. This “considerable yet limited” market size helped shape Korea’s export orientation to some extent, as we will see later in discussing Korea’s showbiz cluster.

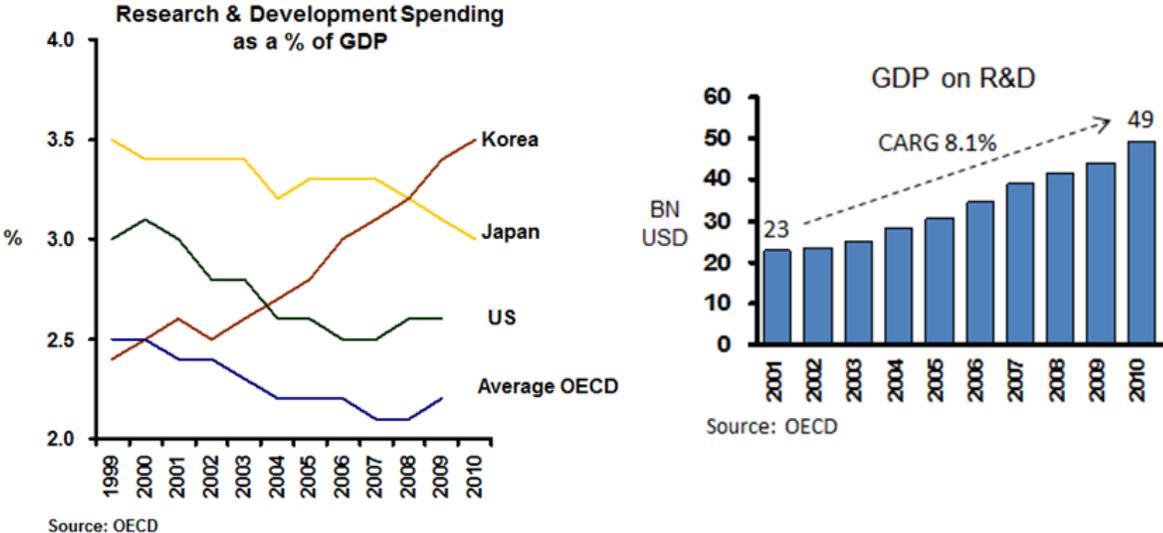
Another distinctive feature

of Korean demand, especially for services, is its comfort with mixing Eastern and Western cultures. Although such phenomena exist in Japan (after the Meiji Restoration) and China (after the 1979 Economic Reform) as well, it appears to be much more salient in Korea. Most observers believe that Korean consumers have been more “receptive” to Western culture, fashion, and styles than other major Asian countries (Haksoon Yim, 2010). Such more “balanced” preference could naturally help Korean firms appeal to a broader range of overseas audiences.

Factor Conditions

Korea has a broad base of skilled human resources. Its tertiary education enrollment rate ranks No. 1 in the world. Quality of math and science education ranks No.8. Both surpass many much wealthier countries. Partially helped by strong human resources, the economy has gradually evolved into an innovation-focused one, spending 3.7% of GDP on R&D, higher than most countries including the U.S. and Japan (Figure 5; WEF, 2012). Over the past decade, Korea’s R&D spending has been growing at a CAGR of 8.1% while many other OECD countries cut back. Despite substantial government support, Korea’s innovation is still largely led by private firms. It ranks No.11 globally in terms of R&D investment.

Figure 5: Trends in R&D spending, Korea and selected countries



Infrastructure is also strong, particularly in technology-related areas. Korea has 37 fixed broadband subscriptions and 105 mobile broadband subscriptions per 100 people, ranking No.5 and No.2,

respectively, among 144 countries. Such robust digital infrastructure enables information and media content to reach consumers instantly and encourage firms to continuously innovate.

Access to capital is a major weakness of the Korean business environment. Since the 1960s, powerful *chaebols* have been receiving bank loans on favorable terms, including lower-than-market-clearing interest rates and government guarantees. In spite of some liberalization efforts during the past decades, serious market distortions still exist in Korea's banking market, causing high borrowing barriers for SMEs (Eduardo Borensztein, 2002). Korea ranks No.115 globally in "ease of access to loans", worse than countries like Kazakhstan and Libya.

Context for Strategy and Rivalry

Korea started its economic growth as a low-cost competitor. However, over the past 30 years, it has successfully evolved into an economy primarily focusing on delivering unique products and services. In this regard, it ranks 16th globally, higher than its GDP per capita ranking. One well publicized example is the Samsung Galaxy's recent eclipsing of Apple's iPhone to become the world's best-selling smartphone, even as it competes within the iPhone's premium price bracket.

Korean firms put enormous focus on exports and foreign markets. This is partially due to government intervention in the various forms. But it is also partially the firms' decision in order to sustain growth, given the considerable but limited size of domestic market. As noted previously, exports account for 56% of GDP in Korea, higher than most economies of similar size.

Korean firms, especially *chaebols*, tend to adopt a "vertical integration" model and become broadly present across the entire value chain. To some extent, this shows Korean firms' sophistication and ability to capture value adds in the global supply chain. But cheap rationed credit from banks and a "too big to fail" mindset may cause these *chaebols* to expand indiscriminately, at the expense of the small and medium players and the economy's overall competitiveness. Due to the presence of *chaebols*, many industries in Korea are dominated by a limited number of players. Globally, Korea ranks 99th on extent of market dominance (with its low rank indicating high dominance). This issue is more prevalent in manufacturing, where *chaebols*' market power reduces competition from SMEs.

In terms of trade barriers and foreign competition, Korea maintains a relatively interventionist attitude, at least by developed economy standards. Its average tariff rate of 8.5% is more comparable to

Russia (10.3%) and Mexico (8.3%) than the United States (1.4%) or Japan (2.3%). Further, the government maintains an extensive foreign investment catalog, prohibiting foreign ownership in many fields (e.g. vocational education, performing arts) and restricting it in even more (e.g. energy, basic materials, agriculture, transportation, broadcasting, publishing, telecom, banking, etc.) (WTO, 2013). The procedure for foreigners to obtain work permits is also difficult.

Related and Supporting Industries

Korea has a solid local supplier base that is consistent with its economic development status. Its local supplier quantity and quality rank 22nd and 25th, respectively, among 144 countries. In certain industries such as electronics, automobile, telecom, chemicals, shipbuilding, and steel, supplier quality is exceptionally strong (WEF, 2012).

Korea's cluster development is at an advanced stage. Many clusters, especially in the manufacturing sector, are deeply developed and globally competitive, such as IT, automobile, marine equipment, and telecom clusters. This is true to some extent for the showbiz cluster as well, as will be discussed in detail later.

2.7 Summary of Key Challenges

Despite enormous past success and many competitive advantages, Korea faces serious challenges as well. Economic growth has slowed down from the 5~10% range during the 1990s to 3~5% in the 2000s. Such leveling happened when the country's income had not even reached half of Japan's or the United States' level (World Bank, 2013). Unease and frustration has spread among citizens. Many believe Korea's industrialization-centered development strategy has become its bottleneck, especially after foreign demand softened following the recent financial crisis. On the other hand, transformation of its growth model is not easy, as decades of industrial promotion left the services sector relatively underdeveloped compared to other developed economies. As Korea's new leader, President Park puts it, Korea needs to become a "creative economy".⁴

Increasing creativity and innovation is easier said than done. One major obstacle is the *chaebols*. "Economic democratization" (i.e. *chaebol* reform) has been on the agenda of every president in the past

⁴ http://english.president.go.kr/pre_activity/speeches/speeches_view.php?uno=7783&board_no=E12&search_key=&search_value=&search_cate_code=&cur_page_no=1

two decades, yet progress has been slow. Vested interest groups remain powerful and the tradition of political favoritism certainly did not help the reform process. Due to the presence of *chaebols*, Korea's financial market is inefficient as well. Distorted lending rates coupled with credit rationing caused tremendous difficulties for SME owners and entrepreneurs.

Meanwhile, the Korean government also needs to tackle increasing inequality. Social spending in Korea is about half of the level of the OECD average. Its GINI coefficient has been rising in recent years. Many citizens worry that they do not have a fair chance to move up the ladder as the social structure solidifies. Although the new administration is treating this issue as a top priority,⁵ changing people's views will be a difficult task.

3. Cluster Analysis: Korean Showbiz Cluster

3.1 Overview

The Korean Showbiz Cluster consists of the combination of activities that produce K-Pop-style music, TV drama series, and film. These three segments together constitute one cluster because they are a “geographically proximate group of interconnected companies and associated institutions in a particular field” (Porter, 2008).

Rising international consumption of Korean Showbiz products, popularly called the Korean Wave, is widely accepted to have been born in June 1997, when the Korean drama *What is Love* was broadcast nationwide in China by the state-run Chinese Central TV (CCTV) (KOCIS, 2008). Korean pop music and motion pictures soon followed, making up the wave's three key elements.

While the cluster has three focal points, the boundaries between the segments are porous (Figure 6). First, the three segments of the cluster provide critical services to each other, as detailed below. Second, they also share human resources and customers, and are supported by a web of related industries. As one Harvard Business School case study on the East Asian Pop Music puts it, “celebrities were trained and promoted by talent agencies, and then went on to act in dramas, endorse advertisements, and, if proven popular, to release albums and hold concert tours” (Siegal and Chu, 2010). Third, firms in the three segments collectively benefit from institutions for collaboration (IFCs) and

⁵ Ibid.

government policies to increase cultural exports. In fact, interdependence between the three segments is one of the cluster's key features.

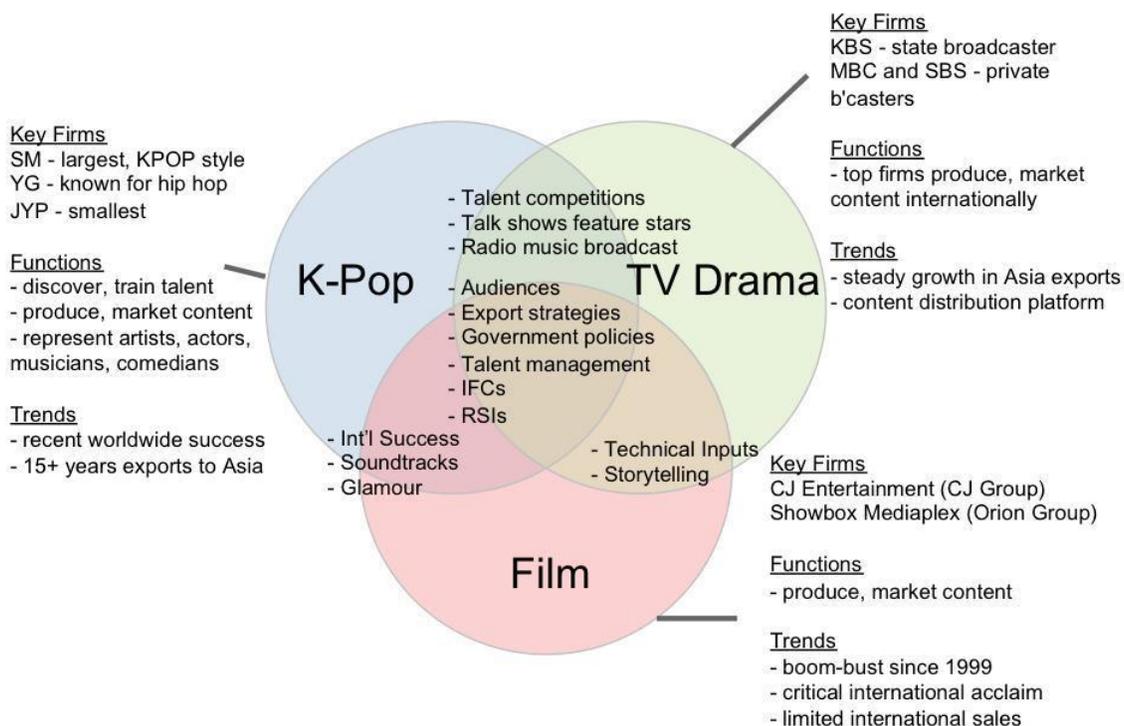
The cluster is centered in Seoul and its surrounding province of Gyeonggi, which together host 46%, 62%, and 87% of music, broadcasting, and film industry employees respectively, exceeding the areas' 44% share of the national population (MCST & kocca 2013).

K-Pop Firms Produce Music, Manage Talent Across the Cluster

In the music segment, three leading firms, SM, YG, and JYP (named after their founders) produce K-Pop music and develop and represent artists. Stars are contracted for a number of years to the firms that launch them, during which time the firms recoup their investments by taking a cut of the stars' receipts, including not only music sales, but also fees for appearances at events, in advertisements, in films, on TV, etc. In addition to music artists, the firms also represent talent from the other two cluster segments, including actors, musicians, comedians, and even magicians.

SM, the largest K-Pop firm, dominates Korea's star management system. The firm is widely credited with launching the K-Pop style and establishing an export-oriented business strategy. The aforementioned HBS case study notes that "since its founding, the company has always positioned itself

Figure 6: Overlapping roles of Korean Showbiz Cluster segments



for the entire Asian market, instead of just Korea” (Siegal and Chu, 2010). Founded in 1995, revenues grew to US\$154 million in 2012, up 50% over 2011. SM is leveraging its market power to expand into additional entertainment segments. The firm has recently sought to broaden its reach, launching a travel services arm and film production unit.

Competitor YG was founded by a former “boy band” member in 1998 and had revenue of \$91 million in 2012. It initially focused on importing the international hip hop wave to Korea. YG represents artist Psy, a recent international success story. JYP, founded in 1997, is the smallest of the three, with a market capitalization of more than US\$100 million.

Top TV Broadcasters Produce and Export Dramas, Distribute Content for the Whole Cluster

The trend-setting firms in the TV drama segment of the cluster are national broadcasters KBS, MBC, and SBS. Along with TV drama, they also air news, talk shows, sports, and other programs, delivered via cable, satellite, radio, and online platforms. They produce dramas and buy content from independent production companies. In addition to airing dramas domestically, they also market and distribute series overseas.

The leading firm, Korean Broadcasting System (KBS), not only produces many of the most popular shows in the category, but also led the segment’s re-orientation away from a strategy of importing foreign content to one of exporting Korean-made content to East Asian markets (Ju, 2010). Founded in 1927, KBS is a state broadcaster akin to the BBC. In 2011, its revenue from a mandatory TV license fee and other government support nearly matched its revenue from commercials.⁶ In addition to KBS, Korea’s top private broadcasters, MBC (Munhwa Broadcasting Corporation) and SBS (Seoul Broadcasting System), also produce and export numerous successful TV drama series. The bulk of their revenue comes from advertising.

In addition to producing and distributing TV dramas, the broadcasters also provide services to the other two segments. The music competition shows they air identify and feed talent to K-Pop. Their variety programs and talk shows generate buzz about established and emerging stars. They also broadcast advertisements featuring the stars, providing a supplemental revenue stream. Their radio stations also promote K-Pop music.

⁶ www.kbs.co.kr/openkbs/report/download/2011_eng/full_e.pdf

Top Film Producer Built Ties to Hollywood, Branches Out to TV Content

Film is the most highly concentrated segment within the cluster, dominated by CJ Entertainment and Media (CJ E&M). The country's top film producer is a subsidiary of the conglomerate CJ Group, which also runs Western-style bakeries in Korea, China, Vietnam, and the United States, as well as biotech, home shopping, and logistics subsidiaries. CJ Group first entered the film sector in 1995 as an early investor in the Hollywood firm Dreamworks SKG. The same year, it began to distribute Western films in Korea. In 1998, it began to build contemporary multiplexes and has since grown to become one of Korea's largest movie theater operators. The company is now expanding that line of business abroad, building IMAX theaters in China.⁷ CJ Group's investment in higher budget films featuring Hollywood-style production values likely contributed to Korean media consumers' expectation of higher quality domestic media content.

CJ Group has also branched out to other segments of the cluster. CJ E&M's MNet division produces K-Pop music⁸, for example, competing with the market leaders. The firm's tvN division produces musical variety shows and TV dramas.⁹

Another top film producer is Showbox Mediaplex, a unit of Orion Group, a conglomerate that makes snack foods, runs restaurants and a sports betting network, and sponsors a basketball team.¹⁰ Founded in 2002, it invests in, produces, and distributes many of Korea's top grossing films. Orion Group has pared back its entertainment portfolio, selling its stake in Megabox, a top theater chain, to foreign investors in 2007.¹¹ In 2010, it sold ON Media, a pay TV broadcaster, to CJ Group.¹² In addition, the Lotte conglomerate, which also began as a food maker, both invests in and distributes films, and runs a chain of multiplexes through its Lotte Entertainment subsidiary.

Related and Supporting Industries Complement Cluster

The three segments also benefit from a variety of interconnections with related and supported industries (RSIs). For example, design firms build stages for live performances and sets and costumes

⁷ http://en.wikipedia.org/wiki/CJ_Entertainment

⁸ http://en.wikipedia.org/wiki/Mnet_Media

⁹ [http://en.wikipedia.org/wiki/TVN_\(South_Korea\)](http://en.wikipedia.org/wiki/TVN_(South_Korea))

¹⁰ <http://www.orionworld.com/ENG/company/entertainment01.asp,-02.asp,-03.asp>

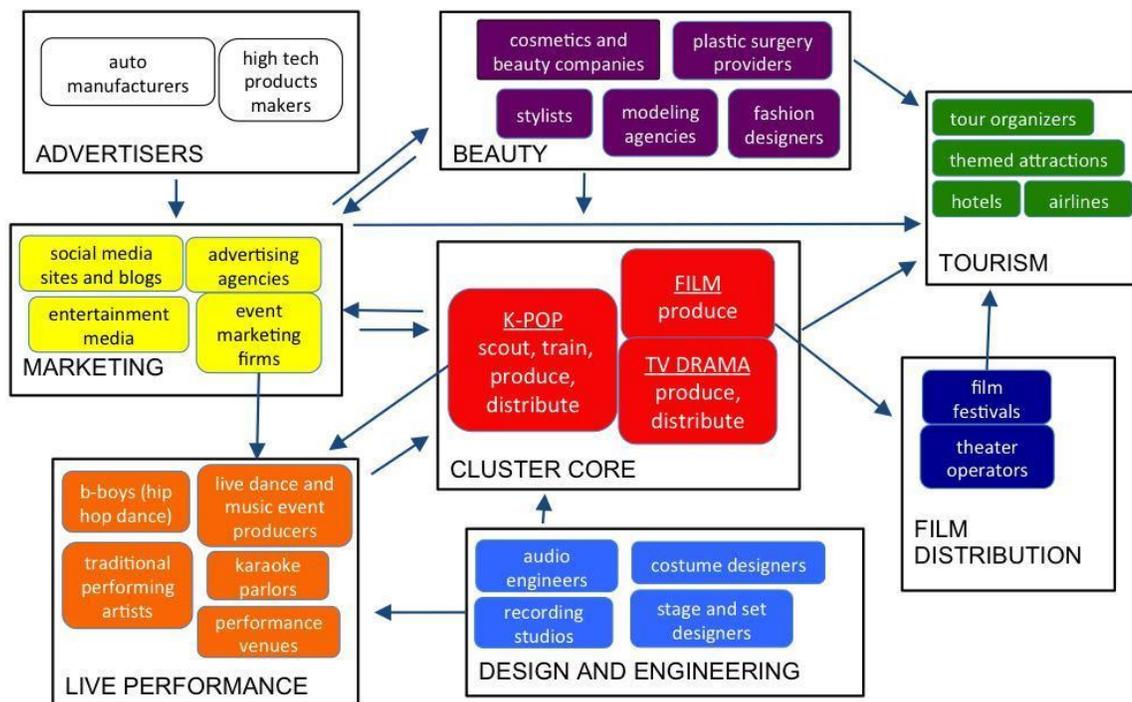
¹¹ <http://www.hancinema.net/orion-sells-megabox-cinema-chain-10189.html>

¹² <http://www.rapidtvnews.com/index.php/201001035494/korean-buy-strengthens-cj-group.html>

for dramas and films. Fashion designers and plastic surgery providers from Korea's beauty industry contribute to K-Pop's iconic visual styles. Marketing and advertising firms promote the cluster's content and also hire its stars for advertisements, adding a new revenue stream.

Meanwhile, a separate set of firms facilitates live performances for singers and dancers of all levels, ranging from ubiquitous neighborhood karaoke parlors to professional shows by the stars. Finally, anecdotal reports suggest fans from across Asia are traveling to Korea to visit sites from their favorite films and TV dramas. These RSIs are detailed in Figure 7.

Figure 7: Cluster map for the Korean Showbiz Cluster



Key Institutions for Collaboration Are Government-Controlled

The Korean government has played a heavy hand in steering the showbiz cluster's development by establishing quasi-government agencies that function like IFCs to facilitate collaboration across the cluster segments. In 2009, several agencies that had promoted individual cluster segments were combined to form the Korea Creative Content Agency (kocca) under the Framework Act on Cultural Industry Promotion. kocca promotes human resources development, cultural technologies, commercialization, exports, and content digitization.¹³

¹³ <http://www.kocca.kr/eng/about/about/index.html>

The Korea Tourism Organization launched in 1962 to develop Korea's tourist market. It promotes themed travel to Korea based on the showbiz cluster. Its website features itineraries devoted to "gangnam style"¹⁴, extensive details on locations from TV drama series and film¹⁵, and K-Pop concert information¹⁶.

The Korea Trade-Investment Promotion Agency, also launched in 1962, identifies "Korean Wave marketing" and support for "cultural content introduction to foreign markets" among its main activities to foster the development of new business areas.¹⁷

Within the government, the Ministry of Culture, Sports, and Tourism (MCST) promotes the development of infrastructure that supports the cluster and seeks to extend its development to related industries, like international tourism. The Ministry's Korean Culture and Information Service hosts K-Pop themed events overseas. Separately, the Ministry of Trade, Industry, and Energy has identified broadcast and communications media and cultural content as new economic growth engines.¹⁸

In addition, private industry associations represent individual cluster segments, including the Korean Film Producers Association, the Korea Movie and Video Industry Association, the Korea Music Content Industry Organization, and the Korea Broadcast Producers Association. In addition, the Korean Film Council (KOFIC), a government-supported, self-administered body established in 1973, has played a major role in marketing Korean films to international audiences.¹⁹

Domestic Educational Institutions are Strong in Performing Arts

In the education field, many Korean universities have well-developed performing arts and design curricula that feed human resources to the cluster. The Korean Academy of Film Arts, run by KOFIC, and the Seoul Drama Academy are prestigious examples. K-Pop firms also train aspiring stars at in-house performance academies. The cluster is also internationalizing its educational platform, as K-Pop firms open star academies outside Korea. The New York Film Academy also runs a program in Seoul.

¹⁴ http://english.visitkorea.or.kr/enu/SI/SI_EN_3_4_0.jsp

¹⁵ http://english.visitkorea.or.kr/enu/CU/CU_EN_8_5_1.jsp

¹⁶ http://english.visitkorea.or.kr/enu/CU/CU_EN_8_7_2_1.jsp

¹⁷ <http://english.kotra.or.kr/foreign/kotra/KHENKT030M.html>

¹⁸ http://www.mke.go.kr/language/eng/policy/Ipolicies_05.jsp

¹⁹ <http://www.koreanfilm.or.kr/jsp/kofic/intro.jsp>

3.2 Historical Timeline

The cluster's origins are in film and pop music, given that television broadcasting began only after the Second World War.. The first film import and screening was in 1897, with the first locally made film in 1919, and the first major film, *Arirang*, made in 1926 (KOFIC, 2008). Korean pop music had its origins in *taejung kayo* (popular songs) around the same period, appearing in commercial recordings from the 1920s (Howard, 2006). Notably, the birth and early development of both genres took place amidst imperial Japanese control of Korea which ended only after the Second World War ended in 1945.

Post-World War II, American military forces continued to have a presence in Korea, and established American Forces Network Korea (AFN-K) in 1945, providing US military personnel stationed there with American radio and TV broadcasting.²⁰ In fact, AFN-K is Korea's oldest TV station, preceding the first local station KBS by four years (KOFIC, 2008). It had a profound impact on Korean popular culture, providing popular entertainment of a quality that local Korean media were unable to match in its first few decades. AFN-K would form the symbol of American influence on Korean popular culture, especially in its film, drama and music, in the decades after its formation, even up until today (Howard, 2006). This period also saw a total ban on all Japanese cultural products in Korea. This lasted until 1998, although some limits on Japanese cultural products, such as the broadcast of Japanese music and television dramas over terrestrial signals, still exist today (Chua and Iwabuchi, 2008)

The post-war period also saw the first locally-produced Korean drama, *The Gates of Heaven* in 1956. This coincided with the first local TV station to be set up in Korea, HLKZ-TV. The 1960s saw the emergence of three other TV stations, one government-run (Korean Broadcasting System, KBS, morphed from HLKZ-TV) and the other two private (Tongyang Broadcasting Corporation, TBC and Munhwa Broadcasting Corporation, MBC).²¹ By 1980, these stations were streamlined into just two stations, KBS and MBC.

²⁰ <http://www.afnkorea.net/AboutAFNKorea/tabid/71/Default.aspx>

²¹ http://en.wikipedia.org/wiki/TV_in_South_Korea

The 1960s and 1970s saw heavy government intervention and control of media content. This was characterized by censorship, propaganda and legislation in order to influence the content and regulate the industries. In 1962, the government enacted a screen quota law for the film industry through Korea's first-ever film law, which is still in force today (KOFIC 2008). In the same year, the Korean Broadcast Reviewing Committee was set up to screen TV and radio content. Up to 1981, a total of 787 Korean and 659 Western songs were banned--without much transparency on the rationale. For example, the first Western song to be banned by the government, *Cecilia* by Paul Simon, suffered the snip because apparently the lyrics expressed the enormous misery of a man dumped by his lover for another man (Chua and Iwabuchi, 2008). This case embodied the extensive government intervention and lack of transparency that has dogged the Korean showbiz industry. The foundations of showbiz were formed in this period, but true industrialization of the business had not yet occurred.

The 1980s and 1990s were the golden age for the showbiz industry. First, the government began to liberalize not just in macroeconomic terms but also in areas specific to the industry. In film, they finally allowed foreign film companies to not have to rely on local distributors to market and distribute their films. The TV industry was opened up almost radically—granting licenses to new stations, introducing cable and satellite TV to the consumer market (Shim, 2008). Local content also flourished with many breakthroughs. Seo Taiji and Boys burst into the scene with their unique brand of Korean hip-hop, launching “K-Pop”.²² The aforementioned *What is Love* became the first of many massive hits in China and the region. New companies that would later drive the worldwide explosion of the Korean Wave were also formed during this period. Lee Soo-Man, widely regarded as the founder of the Korean Wave as it is known today, founded SM Entertainment, the first of many companies built to train and nurture the stars of the Wave.²³ CJ Entertainment and Media was also founded, later becoming Korea's largest film production and distribution and cinema multiplex company.

While the industry always had hopes to break into the international market, the Asian Financial Crisis in 1997 certainly acted as a catalyst to this aspiration. It accelerated the export of Korean cultural products, boosting Korea's export income following the crisis. The weak won and the lower pedigree of

²² <http://en.wikipedia.org/wiki/K-Pop>

²³ http://en.wikipedia.org/wiki/SM_Entertainment

their productions also made their products, especially film and TV drama, more attractive—compared to their Japanese and Hong Kong rivals—to distributors in the region which were now operating on the basis of austerity.

It was really not until the rapid growth of the internet and information technology in the 2000s that K-Pop began to find its space internationally. Other digital innovations, such as social networking and video and file sharing platforms, powered K-Pop's ability to rapidly capture the international market. Fan groups emerged not just out of K-Pop, but for TV dramas as well. This created positive spillover effects for related industries, significantly in tourism, in which fans from the rest of Asia look to vacation in Korea to witness the places at which their idols were featured in their favorite TV serials. The government, eager to capitalize on and add to its success, created institutions for collaboration to support Lee Soo-Nam's vision of "cultural technology," which it thought could be exported just like the manufactured goods, where Korea had succeeded, adding to its export revenue and soft power.

The cluster, though, was not without its problems. The film industry is still trying to recover from a downturn that started in 2005. As the success of the TV drama and K-Pop industries continues unabated, this decline is curious. One reason could be that protection of the domestic industry through the screen quota system, which ensures a minimum number of screen days per year for local productions, reduced the industry's competitiveness (Kim, 2000), so that a temporary string of successes in the early 2000s, heavily concentrated in the Japanese market, was not a sustainable phenomenon. Over production, copycat products, and falling quality standards may have contributed to the decline, which serves as a warning to the other segments of the Korean Wave.

Today, the Korean Wave is a pop culture phenomenon, with the showbiz industry generating much of the buzz as well as the revenue. The record 1.5 billion views of K-Pop phenomenon Psy's *Gangnam-Style* music video on YouTube symbolizes the Korean Wave's success. It remains to be seen if the Wave will endure or will turn out to be a passing fad that the rest of Asia will just copy, catch up with, and forget.

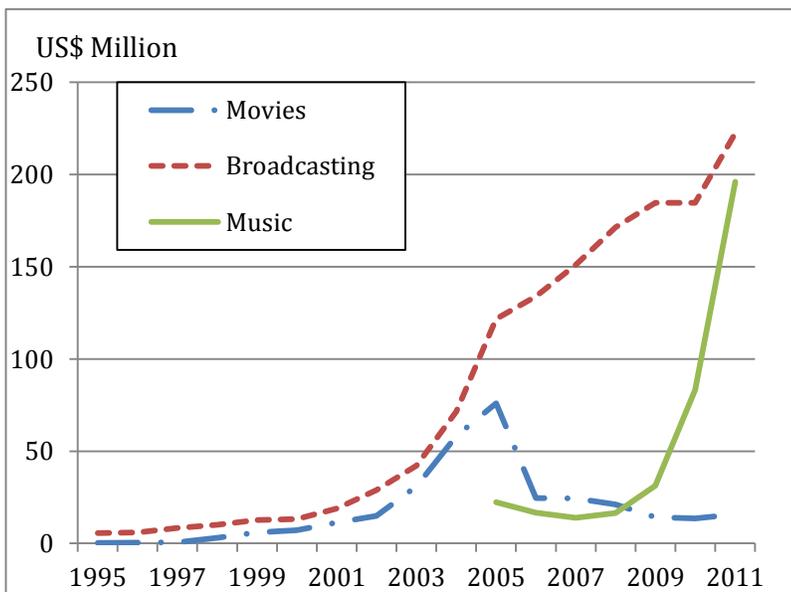
3.3 Cluster Performance

We can quantify the performance of a cluster by looking at data for various performance metrics. Our main focus of analysis will be on export figures, which reflect the international competitiveness of the cluster better than domestic sales figures.

The export performances of the three industries comprising the showbiz cluster are shown below in Figure 8. The general trend has been towards an increase in export figures, but each of these industries has shown a different performance over time.

Within the cluster, exports of TV dramas have been the highest and most consistent, with constant growth over the past 15 years to edge above the \$200 million mark in 2011. Movies have been somewhat of a “vanguard”, with a rapid increase in exports until 2005; since then, however, exports have tumbled, despite a comeback in sales overall. This may be due to a focus on regaining domestic market share in recent years.

Figure 8: Export performance of the showbiz cluster (MCST & Kocca, 2013; Shim, 2008)



Music has seen the most rapid growth in the past few years, with explosive growth since 2008 in particular. More recent hits have become global phenomena - for instance, “Gangnam Style” by Psy, released globally in July 2012, marked 1.5 billion Youtube hits to date.²⁴ A look at the composition of total sales for the music industry (Figure 9) shows both that export values are significant compared with domestic

sales, and that the music industry has enjoyed some success in mastering the shift from physical products to digital products. Indeed, the Korean market is now notable for the widespread use of legitimate music subscription services, with 41% of internet users reporting usage (IFPI, 2013).

²⁴ Official export data for 2012 was not available at the time of writing, but is likely to show further growth.

A breakdown of the export destinations, however, shows some issues of concern (Figure 10). They are focused heavily on Asia, especially Japan. Greater penetration of Western markets is necessary for the showbiz cluster to become truly global in nature, and reduce the risk that a shock in any one market hinders overall performance.

Figure 9: Recorded music sales in Korea (IFPI,2012)

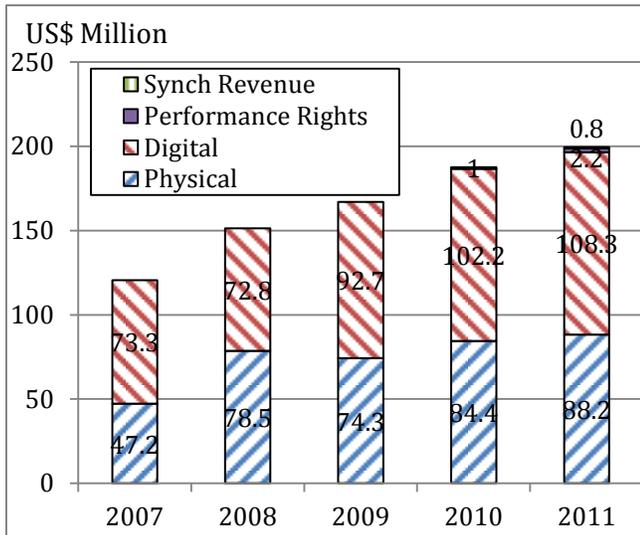
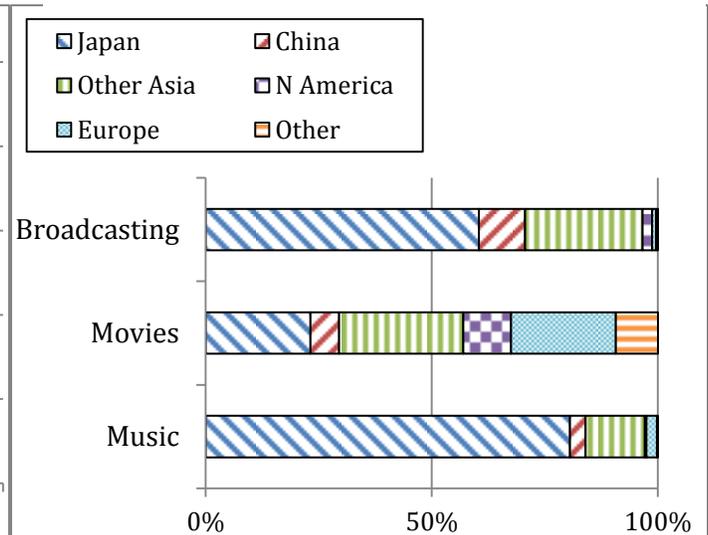


Figure10: Destination of Korean music exports, 2011 (MCST & kocca, 2013)



Economic Impact in Terms of the National Economy Are Small yet Significant

Looking at the impact that the showbiz cluster has on the national economy, direct exports, while growing rapidly to more than \$400 million in 2011, makes up less than 0.1% of total Korean goods and services exports. From this perspective, showbiz cluster exports still seem too small to have any meaningful economic effect at the national level.

It should be noted, however, that there are likely to be significantly larger economic effects from the existence of the showbiz cluster due to positive spill-over effects, both at the firm level and the national level; thus, merely comparing export figures may understate the importance of this cluster.

For instance, the *chaebol* have benefited from sponsoring Korean dramas as part of a public relations strategy. LG Debon, the cosmetics company within the LG group, sponsored the export to Vietnam of the TV drama series “Model” and “Doctors”, featuring actresses Kim Nam Ju and Lee Young-Ag, who were also its brand ambassadors. By attaching commercials of its products to these dramas, LG Debon succeeded in establishing itself in the Vietnamese high-end cosmetics market (Lee, 2010).

Likewise, at the national level, having a platform to boost the image of Korea could be a considerable national benefit, especially given the negative image created by factors beyond its control (e.g. North Korea). Research examining the strengths of different countries' "National Brands" showed that the ranking for Korea's image rose two places in 2012, with the advance "most influenced by "Gangnam Style", which became the most watched video YouTube in only five months" (Lee, 2013).

3.4 Comparison with Key Competing Clusters

When it comes to showbiz, nothing today comes close to Hollywood, located in Los Angeles, California, in terms of size and reach. Total U.S. exports of film and TV services were \$13.5 billion in 2010 (MPAA, 2012), dwarfing the Korean cluster. Hollywood did not arise as a result of specific government intervention or promotion. But like the Korean cluster, it did come on the back of overall national, in particular economic, success in the international arena. Both countries are also developed, with a sophisticated and well-educated population, generating the demand conditions needed to generate products of high quality and innovation, although the U.S. domestic market is far larger. An English-speaking population and ease of access to deep financial markets are two key features that are difficult for Korea to emulate.

The basis for comparison is stronger with Japan. It seems that the reach of the Korean cluster is significantly further than the Japanese one, with some of its products reaching as far as the Middle East and South America. While accurately comparing the two is difficult,²⁵ UN services trade data for "Personal, cultural, and recreational services" show that Korean exports in 2011 were roughly 6 times larger than Japanese exports, despite the much larger size of the Japanese economy (UN, 2013). The fact that the Japanese showbiz industry is significantly more sizeable than its Korean counterpart²⁶ may be the greatest reason behind this difference: there is much less orientation towards exports, and a greater focus on the specialized domestic market. Perhaps because Japanese, like Korean, is not spoken elsewhere, the domestic base did not translate into an international presence.

²⁵ The very fact that government statistics for showbiz trade are unavailable for Japan is suggestive of the lack of systemic focus on exports in this area.

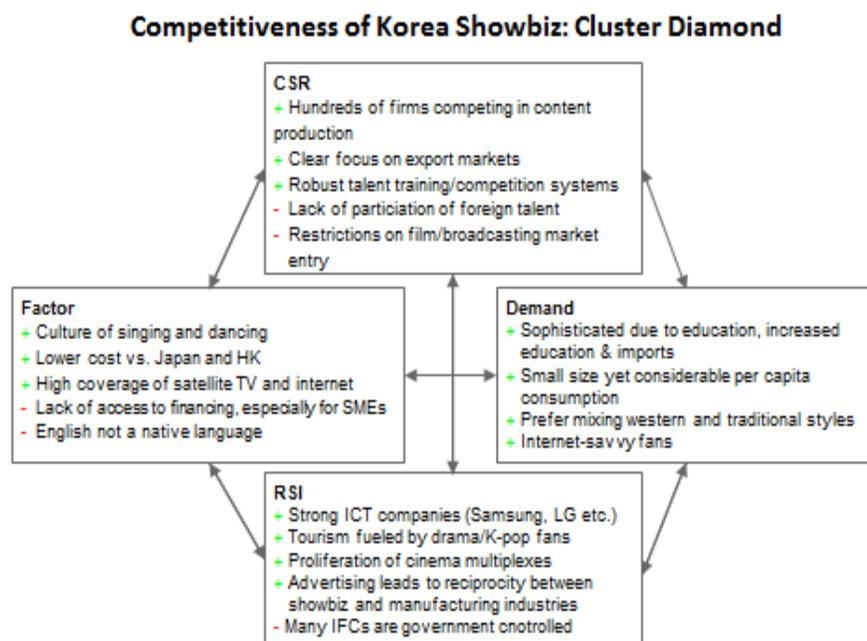
²⁶ For instance, Japan's recorded music market is approximately 20 times that of South Korea (IFPI 2012).

Another regional competitor is Hong Kong, with a cluster centered on the film industry. Famous for its international superstar Jackie Chan, it had a strong regional presence in the 1980s. The cluster has been in decline since the 1990s, however, with annual production dropping from a peak of more than 150 films to barely 50 in recent years. Reasons given for this include foreign competition, piracy, shrinking of overseas markets, decreased quality of scripts due to complacency and the plaguing of production by organized criminal activities (Teo, 2008; Strauss, 1998). These factors caused its stars, such as Jackie Chan and Chow Yun Fat, to ply their trade overseas, particularly in Hollywood, and led to it being overtaken by the Korean cluster despite superior competitiveness conditions compared to Seoul (EIU 2012). This serves as a sobering lesson for the Korean cluster, which is not without allegations of malpractices such as worker exploitation and corruption.²⁷

3.5 Assessment of Cluster Competitiveness

While the cluster has enjoyed a boom in exports, questions remain about the sustainability of its recent strong performance. Current growth is concentrated in the K-Pop segment of the cluster, where past attempts to break out of the Asian market were inconsistent at best (Jordan and Kwan, 2010). Inconsistent performance by Korean film and limited success of Korean TV dramas outside Asia

Figure 1: Cluster diamond for Korean showbiz



suggest recent international success may be difficult to replicate. An analysis of the business environment suggests that while RSIs are strong, factor and demand conditions are mixed, and the context for firm strategy and rivalry requires improvement (Figure 11).

²⁷ <http://www.bbc.co.uk/news/world-asia-pacific-13760064>

RSIs and Cluster Segments Provide Complementary Services that Enhance Productivity

A key source of strength for the cluster is its breadth. Each of the three segments provides critical inputs to the other two. K-Pop firms manage artistic talent across the sector. Broadcasters operate distribution channels that deliver content from all three segments. Critically acclaimed films provide glamour and sophistication. Anecdotal reports also suggest that fans of one segments often become fans of the others. Together, they promote tourism and support an ecosystem of design, engineering, and beauty firms.

However, concerns exist. The government directs key IFCs, limiting their independence. Meanwhile, firms have adopted a strategy of horizontal and vertical expansion across the cluster and into RSIs, which could prevent their specialization and may limit competition.

Factor Conditions Enable Korea to Bridge Asian and Global Cultures

One reason for Korea's success is cultural. The country has succeeded in preserving ancient cultural elements at the same time that it has achieved wealth and modernity. This combination appears to resonate with regional audiences. At the same time, the country appears to have combined a strong indigenous cultural tradition of song and dance with a contemporary flair for visual presentation to package a new spectacle that intrigues international fans. In addition, the country's investment in performing arts and design education has created a qualified and talented pool of human resources. Meanwhile, its well-developed communications infrastructure facilitates content delivery. Finally, Korea's location at the crossroads of Northeast Asia allowed it to benefit from long-standing information transmission networks.

At the same time, one reason for the cluster's success has been its cost advantage over regional competitors. This is an unsustainable advantage. Wages will rise with productivity and Korea cannot afford to compete with countries like China and Thailand on costs.

Demand Conditions – Local Preference for International Fusion and Higher Quality

We postulate that another reason for Korea's showbiz success is the preference by local customers for products that blend indigenous and Western tastes. This contrasts with regional competitors Japan and China, where consumers exhibit a preference for entertainment products that

more closely reflect local culture. At the same time, Korea's relentless drive toward prosperity has led consumers to expect better quality across all consumer product categories.

However, the limited success of Korean showbiz outside of Asia reflects the fact that quality does not consistently meet international standards. Musical styles have been criticized as "derivative".²⁸ Limited proficiency in English for some may also prevent stars from connecting with audiences.²⁹

Room to Improve Context for Strategy and Rivalry

The showbiz cluster benefited significantly from changes in government policies that enhanced competition and incentivized investment in intellectual property. Censorship was loosened following democratization. Government-sponsored enterprises like KBS were freed to pursue commercial strategies. Regulation restricting foreign investment and protecting domestic content were liberalized. Sanctions targeting illegal file-sharing have helped protect intellectual property in the domestic market and shifted the digital music market towards legal, subscription-based services (IFPI 2013).

However, the government retains a heavy hand in setting the cluster's overall direction. The screen quotas, while substantially reduced, remain in place. Content distribution appears to be heavily concentrated among a few firms, at least partially due to heavy regulation of the broadcasting industry. Reported exploitation of talent suggests illicit activities that could corrupt the competitive process, tarnish the cluster's brand, and undermine human capital development.

Cluster-specific government policies

Government policy has played a key role in the growth of the showbiz industry. In addition to managing the general regulatory environment as noted above, the government has directly encouraged the development of the industry, for instance by providing public funds to reduce the risk of private investment in film production (Choi, 2010). It has also supported regional content industry clusters, specifying districts to provide tax benefits and relax government regulations (JETRO 2011), although given the continued dominance of the Seoul region the impact of the policy is somewhat debatable.

Just as importantly, the most influential IFCs are independent government agencies, and have pursued their activities primarily through government funding. In addition to indirect support, such as

²⁸ <http://www.hancinema.net/making-it-in-the-big-time-K-Pop-wants-u-s-air-play-5288.html>

²⁹ The greatest global K-Pop star so far, Psy, has adopted a strategy of using Korean and simple English phrases in his songs, but is fully fluent in English and can connect to fans globally. Comments at Harvard University (May 9th 2013).

hosting trade fairs³⁰ and developing specialized human resources through directors' and actors' schools, some, including koCCA³¹ and the KOFIC (KOFIC 2012), provide direct financial support for production and editing in order to promote exports as an end in itself, as opposed to the natural outcome of the cluster's competitiveness. This has reinforced the export orientation of Korean companies that was present even in the absence of such support.

3.6 Summary of Key Challenges

While the cluster has experienced rapid growth and exports, concerns remain about the sustainability of its recent performance. Competition within the cluster is limited. Many of its leaders are vertically and horizontally integrated conglomerates that dominate key parts of the value chain, a structure that can foreclose parts of the market to competition. SMEs lack access to capital. Foreign investment in media is restricted. The state is heavily involved in the sector: ministries set direction, and key IFCs are quasi-state agencies. The top broadcaster receives half its revenues from the government. Together, these issues risk inhibiting innovation and politicizing commercial decisions.

In addition, apart from the current popularity of K-Pop, the cluster's international performance has been inconsistent. The drama segment has hardly broken out of Asia. Local demand has become more sophisticated, but may not reflect international tastes. Western critics have labeled K-Pop music as "derivative". Comparatively poor performance in film may limit complementary growth. This mixed international performance may be caused by the fact that apart from some exports, the cluster's cross-border ties, especially outside Asia, are limited. Restricted foreign investment limits collaboration. The cluster does not employ significant foreign managerial or artistic talent, and foreign co-productions are rare. If these issues are not addressed, the Korean Wave risks becoming a passing fad.

4. Recommendations

The Korean showbiz cluster should position itself as a constantly-innovating and intensely competitive cluster, representing the intersection of Eastern and Western cultures so as to maintain its

³⁰ For instance, the the Busan International Film Festival has been held since 1996 to showcase Korean films.

³¹ <http://www.koCCA.kr/eng/activities/activities/index.html>

³¹

appeal in Asia yet extend a global reach. Its unique idol-centered training system and adoption of new styles and technologies should be key components to achieve sustained success.

Despite notable achievements in gaining international competitiveness, both the Korean economy and the showbiz cluster need to overcome significant challenges in order to achieve this goal. Our key recommendations for the showbiz cluster, based on the preceding analysis, are outlined below.

1. Enhance competition within the cluster and reform the chaebol-centric culture. (CSR)

The government should:

- [Priority: High] Instruct the Korea Fair Trade Commission (KFTC) to tighten and more aggressively enforce the Monopoly Regulation and Fair Trade Act for broadcasting companies, talent management firms and film production companies
- [Priority: High] Relax restrictions on foreign investment and foreign ownership, especially in the broadcasting sector to allow foreign content distributors to enter the market, as well as the educational sector to allow showbiz-related vocational training by foreigners
- [Priority: Medium] Enact a staged reduction and abolishment of the screen quota system, over a period of around five years

Cluster firms should:

- [Priority: Medium] Maintain strategic focus on the core showbiz sectors and avoid excessive expansion into non-core areas, such as the CJ Entertainment's involvement in multiplexes and SM Entertainment's involvement in tourism

2. Encourage greater foreign (especially non-Asian) involvement and collaboration in the cluster. (CSR)

The government should:

- [Priority: Medium] Relax and simplify work permit application procedures for foreign talent, including managers and artists

Cluster firms should:

- [Priority: High] Through joint ventures and co-production, collaborate with world-class showbiz companies to enhance product offerings and bring in new ideas and strategies.

- [Priority: Medium] Actively hire and assimilate foreign artists and managers, especially from other leading showbiz clusters such as Hollywood, in order to develop products with a greater global appeal.
- [Priority: Low] Provide greater English training to both artists and managers.

3. Facilitate financing to SMEs in the cluster to generate new ideas outside the conglomerates that are capable of funding their own expansion (Factor Conditions)

The government should:

- [Priority: High] Encourage banks and professional venture capital firms to increase financing to SMEs, especially start-up firms, through partial credit guarantees and other forms of risk sharing

4. Transform the roles of IFCs (RSI)

The government should:

- [Priority: Medium] Give a greater role to the private sector in managing the key IFCs, such as replacing the management of Kocca with private sector individuals

IFCs should:

- [Priority: Low] Publish periodic reports detailing the amount and nature of government funding, to increase transparency and efficiency.

5. Others

The government should:

- [Priority: High] Investigate and rectify industry malpractices, including alleged exploitation of young performers, to ensure that the cluster remains healthy and maintains a good reputation

Cluster firms should:

- [Priority: Medium] Continue to adopt new technologies and create and refine business models accordingly, e.g. introducing subscription-based digital music channels overseas

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