

## Franchising in South Korea

### FRANCHISING IN SOUTH KOREA

#### Korea : essential data

South Korea, with an area of 99 601 km<sup>2</sup>, occupies the southern most half of the Korean peninsula, in the south of the demilitarized Zone (DMZ), near to the 38<sup>th</sup> parallel, which constitutes since 1953 the demarcation line with North Korea. It neighbors are China on the west and Japan on the east. The federal capital is Seoul with 9.9 million residents for a total population of 48.2 million. The population is 80% urban and concentrated on the coast and valleys. The density of 484 residents per km<sup>2</sup> is one of the most important in the world because of the 2/3 uninhabitable territory. The last census recorded only 151,000 foreigners in Korea (0.3 % of the total population) of Chinese, Sino-Korean, Japanese, Philippine or American nationality. South Korea has largely completed its demographic transition and the accelerating ageing of its population and its impact on welfare has become a real challenge for the country. Korean is the national language. Buddhism and Protestantism are the two prevailing religions.

On the political level, South Korea initially under the Chinese influence was a Japanese colony until the Japan's capitulation in 1945. South Korea is now under a vigorous presidential regime. The constitution in force goes back to 1987. The legislative power is assumed by a single Chamber. M. Roh Moo-hyun, elected as President of the Republic in December 2002, has bound himself to follow his predecessor's engagements concerning the structural economical reforms for more transparency in management and business and the dialogue with North Korea. South Korean law is inspired by European laws, and particularly German law.

#### Economy in South Korea and the sector of distribution.

In 2005, South Korea's Gross Domestic Product was estimated to be US\$ 810 billion (Agriculture accounted for 5 % of the GDP, the manufacturing sector for 46% and services 49 %). Growth grew by 3,9 % in 2005. The unemployment rate is low (3.8 %) and the inflation rate is about 2.7 %.

The retail sector is structured mainly through the 85 shopping centres, with two-thirds in Seoul or in its periphery. Three main actors dominate : Hyundai, Lotte (grocery, hostelry, petrochemistry...) and Shinsegae (Samsung Group), called the "Big-3". A fourth group, Galleria (HANHWA group, retail, defense industry, high technologies, financial services...), recently entered the landscape. The "Big 3+1" represents almost 60 % of the total number of the shopping centres and 80% of the market turnover. These shopping centres are characterized by structured marketing and advertising departments. That is why they pay a detailed attention to complementary services to attract customers : parking, nursery, private courses... They moreover propose cultural spaces where exhibitions, plays and fashion parades are performed. Lastly, they are more and more specialized in luxury brands, imported goods (15% of the products sold in shopping centres) and products under foreign licences (25% of the products sold by shopping centres).

In 2005, two worldwide retail giants disappeared from the Korean landscape : the French Carrefour and the American Wal-Mart. The first one sold 32 stores to a new born in this sector, which is specialized in clothing. Wal-Mart sold its outlets to the Korean leading E-mart of the Shinsegae Group.

The two important groups Lotte and Shinsegae compete on vast "resort shopping centre" projects. The Lotte's project should open close to the Gimpo airport in 2010. It should extend on 195.000 sq.m and include besides a shopping center, a hotel, a fun fair, cinemas and multitude of restaurants. Shinsegae intends to open a similar

centre in 2009 in the town of Pusan where there is no centre yet.

In the wake of the “Big 3+1” one finds other chains more modest but still customer oriented : New Core and LG Department Stores. There are also smaller stores offering less imported products and their financial power is quite less important than the others and they only have a limited local influence.

Franchise in Korea is very active. There are currently more than 120,000 franchisees for 1,600 Franchisors. The Korean franchise generally groups small trades. The average number of employees is 3.7 for an annual average turnover of € 145,000. The franchise sector employs 2.6% of the working population (about 570,000 people) and had a turnover of 45 billion Won in 2002 (about € 34.6 billion) or 7.7 % of the Korean GDP.

This method of business is becoming a society phenomenon : more and more institutes and associations propose specialized courses. The presence of foreign franchisors is still modest and their activities are concentrated in food. But prospects are encouraging in a market that is far from saturated.

## **The Fair Franchise Transaction Act 2002**

In 2002, South Korea adopted a specific legislation for franchising, the Fair Franchise Transaction Act 2002. This strict legislation deals with the execution, obligations and termination of the franchise agreement that is to be operated within South Korea. Penalties are envisaged in case of violation of the law.

Requirements for the settlement of the agreement are the same as those provided in the French law. The Franchisor must provide an Information Disclosure Statement to the prospective franchisees.

Requirements for the execution of the franchise agreement are quite similar to the French contractual mechanisms : good faith in the performance of contractual obligations, reciprocal performance of parties' obligations, written notification of the non-renewal of franchise agreement at least ninety (90) days prior to the date of expiration of this franchise agreement.

However, a characteristic exists in the South Korean law, which establishes a Franchise Transaction Dispute Conciliation Council. This Council shall mediate -if all parties agree- over franchise Transactions as requested by the Fair Trade Commission or the Parties in dispute. The mediation by the Council is not compulsory.

Furthermore, a body named “Fair Trade Commission” can request from franchisors that they modify the contract.

The criminal sanction envisaged in case of providing of false or exaggerated information is a fine of 150 million Won and/or a prison sentence of five years maximum. Moreover, if the law has been violated, several criminal sanctions exist, from 50 million to 100 million Won with a maximum imprisonment of 3 years.

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