

Prospective Business

Understanding the Opportunities and Risks of Doing Business with North Korea

KPMG Korea is a member firm of global audit, tax and advisory company KPMG International, which provides comprehensive knowledge services on audit, tax, finance and business management. It supports the globalisation of South Korean companies that are making inroads into foreign markets, by collaborating with KPMG's global network of more than 200,000 professionals across 154 countries, and serves as a driving force for South Korea's economic development.

KPMG Korea North Korea Business Center was founded in June 2014 to support inter-Korean economic cooperation and North Korea business projects. The centre consists of experts in the areas of audit, tax and advisory, and serves as a "North Korea business advisor" for corporate strategies to enter North Korea, project feasibility assessment, project financing, as well as country development and investment.

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Praise for Prospective Business

A Primer on Doing Business with North Korea

In 2018, the long-awaited inter-Korean summits and the US-North Korea summit became a reality. Since then, there has been a growing expectation that inter-Korean relations will make progress and that economic cooperation will resume.

The South Korean government has consistently worked to establish permanent peace by addressing the issue of North Korea's nuclear programme and to actualise a new economic community on the Korean Peninsula by improving inter-Korean relations. The inter-Korean summits are the product of these relentless efforts. This is undoubtedly good news to those who have been waiting to resume business with North Korea. However, it is precisely during times like this that we need to calmly reflect on past experiences and thoroughly prepare ourselves for the future.

The Korea International Trade Association (KITA) has been carrying out various projects to support inter-Korean trade for some time now. In the process we came to recognise the myriad of difficulties that companies encountered when doing business with North Korea, and we became more acutely conscious of the importance, first of all, of being prepared before working with North Korea.

The KPMG Korea North Korea Business Center has, meanwhile, published this book. It is done at an opportune time as it systematically organises the information that people are curious about and should know of when doing business with North Korea. I believe that this book will meet the expectations of those who plan to do business with North Korea, and as the chairman of KITA, I am pleased to recommend it.

KPMG Korea is a front-runner in the audit and consulting industry. As befits its position in the industry, it saw the need for and the possibility of inter-Korean economic cooperation early on, and founded the North Korea Business Center in June 2014. It took them more than two years of research and consultation to get the book published. The publication task force consists of thirty people, with twenty industry-specific specialist writers alone. A significant number of people, including external advisors and individuals involved in inter-Korean economic cooperation projects, have participated in this book's publication.

This book is not a major statement about the vision of a unified economy. Simply put, it is a strategic consultancy report on doing business with North Korea. The book analyses in depth and breadth both the appeal and the risk factors of the North Korean market from a comprehensive business perspective, and proposes phased entry strategies in tandem with the progress in inter-Korean economic cooperation.

It has been eight years since inter-Korean trade was discontinued as a result of the May 24 Measures.¹ Over the years, the number of individuals from the private sector, government ministries and aid agencies who are involved in North Korea projects has decreased significantly. It has also become more arduous to collect information on North Korea. Most publicly available information has been subjected to diverse interpretations because it is either fragmentary or its authenticity is uncertain. This is why voices of caution have of late grown increasingly strident as expectations mount about resuming business with North Korea.

I believe that this book will play a significant role in alleviating misunderstandings and misgivings regarding North Korea. There is extensive and diverse research about North Korean business contained within these pages. There are also numerous insights to be gleaned from them. I heartily recommend this book to entrepreneurs who have a vested interest in doing business with North Korea, as well as government officials who should lay the groundwork for taking a major step forward in inter-Korean economic cooperation, and those who want to understand North Korea a little more deeply.

Yeong-Joo Kim

Chairman of the Korea International Trade Association

Acknowledgements

Awaiting the “Springtime” of Economic Cooperation

The situation on the Korean Peninsula has evolved considerably with the 2018 Pyeongchang Winter Olympics, and there has been a growing sense of anticipation about the resumption of inter-Korean relations, which have been severed and strained over the years. We hoped that the Inter-Korean Summit at the end of April 2018 would lay the foundations for the stable development of the two Koreas and for establishing peace on the Korean Peninsula. Inter-Korean exchange and cooperation can decrease geopolitical risks and be a channel that opens up another market to South Korean companies while creating peace and prosperity for the two Koreas.

In times like these, I am pleased that our firm’s North Korea Business Center has published *Prospective Business* after a two-year writing process. KPMG Korea founded the North Korea Business Center in June 2014 to support the inter-Korean economic cooperation and North Korea business projects of companies, from the point of inter-Korean economic cooperation until unification. The centre comprises experts from various specialisations, and we intend to faithfully perform our role as a “North Korea business advisor” to advise on corporate strategies to enter North Korea, project feasibility assessment, project financing, and country development and investment. This book – the first consultancy report from the centre – contains insights gleaned from our research and deliberation on solutions for South Korean and foreign companies’ entry into North Korea.

This book consists of three broad sections. Part One, “North Korea – A New Market”, examines North Korea’s potential as a market by analysing the present state of its economy and industries, and sheds light on its attractiveness as an investment destination. Part Two, “Discovering New Business Opportunities”, describes business opportunities and market entry strategies in seven promising sectors in North Korea: infrastructure and construction, distribution and consumer goods, information and communication technology (ICT), energy, resources, automobile, and tourism; it also collates a list of financing methods and legal and systemic considerations crucial for pursuing business projects. Part Three, “A New Perspective – The Pursuit of Sustainable Development”, proposes

solutions for development cooperation with North Korea, from the perspective of sustainable development – a future-oriented development paradigm.

“By failing to prepare, you are preparing to fail.”

These are the words of Benjamin Franklin which underscore the importance of assiduous preparation. It means that even when we are faced with a new and foreign environment, we can adopt change as a stepping stone to taking a bigger leap forward – as long as we are prepared ahead of time. When we were preparing this book, we strived, above all, to offer practical and strategic solutions to companies that are preparing for inter-Korean economic cooperation. I hope our efforts will serve as a beacon that lights the road ahead for South Korean and foreign companies that are walking the path of economic cooperation with North Korea which remains shrouded in uncertainty, and as a useful guide to unlock the future of mutual prosperity for the two Koreas.

In the course of planning and preparing this book, we received the help of countless individuals. First, we want to convey our deep gratitude to Yeong-Joo Kim, Chairman of KITA, who was delighted to look through our manuscript and wrote a recommendation for the book. We also wish to sincerely thank our advisory committee, who supported our work at KPMG Korea North Korea Business Center and enhanced the completeness of the book with their brilliant insights. Without their invaluable criticism, it would have been difficult to bring this book to fruition. I wish to thank all the members of the North Korea Business Center, who spared no effort in writing this book. We wish to convey our deepest appreciation to Doon Books, who did their utmost to publish this book in a timely manner. We also want to express our deep gratitude to Harriett Press for translating and publishing this book.

I hope these pages will offer companies the opportunity to consider North Korea market entry in a different light – at the private, public, and academic levels – and become the starting point of lively discussions, including investing in North Korea. It is my wish that we draw up better plans for North Korea and South Korea to prosper together, with further research and studies in the future.

Kyo-Tae Kim
CEO of KPMG Korea

Prologue

The Crisis of South Korea, The Opportunities in North Korea

South Korea faces the risks of “four lows, one high”: low growth, low consumer prices, low employment rate, low fertility rate, and a high number of elderly people. Caught in the middle-income trap, South Korea has not been able to surpass a GDP per capita of US\$30,000 for several years and retains the status of a developing country. We maintained our potential growth rate at six to seven percent in the 1990s, before arriving at five percent in the 2000s and dipping to three percent after 2006. After the inflation rate exceeded four percent in 2011, consumer prices fell to a record low of 0.7 percent in 2015; they recovered to one percent in 2016 and 1.9 percent in 2017, but prices remain low. Low consumer prices are a clear indicator of weak domestic demand. Employment is also on a downward trend, quantitatively and qualitatively. The youth employment rate remained at forty percent until the early 2000s, but it decreased to 39.7 percent in 2013 before increasing slightly between 2015 and 2017. Nevertheless, the number remains low.

Apart from this, a low fertility rate and an ageing society are looming detonators for the South Korean economy. The International Monetary Fund (IMF) has also pointed out that these are the most serious and pressing problems that the South Korean economy must address. South Korea has one of the lowest fertility rates among Organisation for Economic Co-operation and Development (OECD) countries at 1.05 in 2017. We became an ageing society in 2000, an aged society in 2018, and will soon become a super-aged society in 2026. Compared with Japan which took twenty-four and twelve years to become an aged and super-aged society respectively, South Korea evolved more rapidly at eighteen and eight years respectively, and this has become a major cause of declining economic vitality. Our working-age population has gradually declined after peaking at 37,630,000 persons in 2016, and the downward trend will likely accelerate further in 2020, when the baby-boomer generation joins the ageing population of people above the age of sixty-five.

These problems that beset the South Korean economy has resulted in the shrinking of the labour market, reduced demand, worsened profitability of

companies, diminished investment, and a decline in personal assets, and this vicious cycle is the key factor that is challenging the progress of the South Korean economy. In this context, the Fourth Industrial Revolution will become a major challenge to existing industries.

The South Korean economy is now standing at a major turning point. On one hand, we should restructure the domestic environment for economic growth by adopting every kind of reform measure, and on the other hand, we should eagerly strive to create new markets and growth drivers overseas.

The global economy has maintained a growth rate of three percent and entered an era of low growth since 2010. Increased uncertainty caused by Brexit in the United Kingdom and Donald Trump's presidency in the United States, global trade slowdown, growth stagnation of emerging markets like China and India, interest rate hikes in the United States amidst a global trend of low interest rates, and the rise of private debts in emerging countries have cast a dark shadow of low growth on the global economy. In particular, the economic slowdown of the BRIC (Brazil, Russia, India, and China) countries, which were leading global economic growth and dominating emerging markets as a strong power, has become a reality, and emerging markets, including the BRIC countries, are slowly losing their appeal as production and consumer markets of global companies. In recent years, the economies of emerging countries have been picking up and global inflationary pressures have surfaced, but their strengths – low interest rates and low-cost production markets – have been weakening.

Global companies are therefore paying close attention to untapped markets that are highly profitable, as they explore new markets to produce and sell goods and services. They understandably aspire to be pioneering trailblazers who are the first to set foot into an unknown land and a future market that holds potential, while they discern the generational changes in industrial paradigm shifts.

As such, what opportunities does North Korea offer South Korea as an unknown land and untapped market?

First, it would be a major boost to the South Korean economy if South Korea builds amicable relations with North Korea and both security and geopolitical risks are eliminated. South Koreans tend to underestimate the risks that North Korea poses though overseas investors pay close attention to and are apprehensive about the unstable relationship between the two Koreas. Hence, the stable management of inter-Korean relations and the strengthening of economic cooperation will therefore contribute significantly to our economic growth.

Second, North Korea can offer South Korea a new market. North Korea not only offers a domestic market with twenty-five million people; it also provides a more accessible route to the three northeastern provinces in China with a population of 110 million people, and to the vast Eurasian continent that cuts through Central Asia, including Russia's littoral provinces. When an estimated population of more than 200 million people melds into a single market with South Korea at the heart of it, it lays the foundation for building a truly Northeast Asian economic community. South Korean companies can obtain high-quality and inexpensive labour from North Korea. Securing a production base that taps into cheap land lease can also be a bonanza that presents a new way out for South Korean companies.

North Korea not only functions as an effective production base and consumption market to South Korean companies, it also offers a vast export market at our doorstep. For South Korea to overcome the present growth stagnation and achieve continuous economic growth, it has become ever more pressing to work with North Korea.

In the longer term, it is also crucial to lay the foundation for mutual prosperity and economic integration. The Moon Jae-In administration's decision to roll out plans for a new economic community on the Korean Peninsula and to mobilise The Presidential Committee on Northern Economic Cooperation would likely have incorporated strategic assessments for actualising these possibilities. As a country faced with the prospect of unification, this might also cement the resolve of the Moon administration to lead the way in pursuing mutual growth, reconciliation, and cooperation with North Korea. Having had successfully concluded the 2018 Pyeongchang Winter Olympics, South Korea will continue to actively find ways to resolve North Korea's nuclear programme and to invest and cooperate with North Korea.

Translator's Note

In *Prospective Business*, I have adopted slight variations of two romanisation systems: Revised Romanisation (RR) and McCune-Reischauer (without diacritics and apostrophes) (MR) for South Korean and North Korean subject matter respectively. This is to help readers conduct independent research more effectively. RR has been officially used in South Korea since the early noughties, while most open-source material on North Korea has been translated using MR. Insofar as it is feasible, I have also provided some updates in the Notes section on certain events that have transpired since the book was first published in Korean in 2018. The monetary figures that appear in the book are converted from South Korean won to US dollar at US\$1 to 1,200 South Korean won.

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