The Consumer Internet in South Korea: An American's Perspective

by

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BA Economics, University of Pennsylvania, 2000

Submitted to the MIT Sloan School of Management
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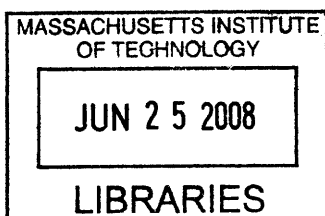**Massachusetts Institute of Technology**
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ABSTRACT

This thesis will explore the consumer internet industry in South Korea from the perspective of an American with Western values and sensibilities. South Korea is widely considered to be one of the most connected and internet-savvy countries on Earth, with roughly 90% of the population having high-speed broadband access and the average Korean spending 31.2 hours viewing 4,546 web pages per month compared to 25.2 hours viewing 2,519 pages for the average user globally. Moreover, South Korean portals such as Daum and Naver are two of the most trafficked destinations on the web despite the fact that their content is only available in Korean. Consequently, South Korea has become a valuable testing ground for internet technologies and an important market that can serve as a springboard to the rest of Asia.

Yet the consumer internet in South Korean retains a distinct local flavor. For better or for worse, the consumer internet industry in South Korea has been deeply influenced by Confucian principles and Korean culture. The path to success for internet firms in South Korea is often quite different than it is in the West, and foreign firms looking to establish a Korean presence need to adjust their strategies accordingly.

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1. INTRODUCTION

By some accounts, South Korea is the most wired country on the planet. Roughly 90% of the population has broadband internet access and in the greater Seoul metropolitan area, the penetration rate actually exceeds 100%. Broadband connection speeds average between 50 and 100 megabits per second in South Korea versus 4.6 megabits per second in the UK. The average Korean spends 31.2 hours viewing 4,546 web pages per month compared to 20.2 hours viewing 2,171 pages for the average user in Asia and 25.2 hours viewing 2,519 pages for the average user globally. And an impressive 57% of music sales in South Korea were digital in 2006, while only 10% of music sales were digital in the US during the same time period.

More importantly, South Korea is continuing to experience growth in both the internet usage rate and in the number of internet users, albeit at a declining rate (see below).
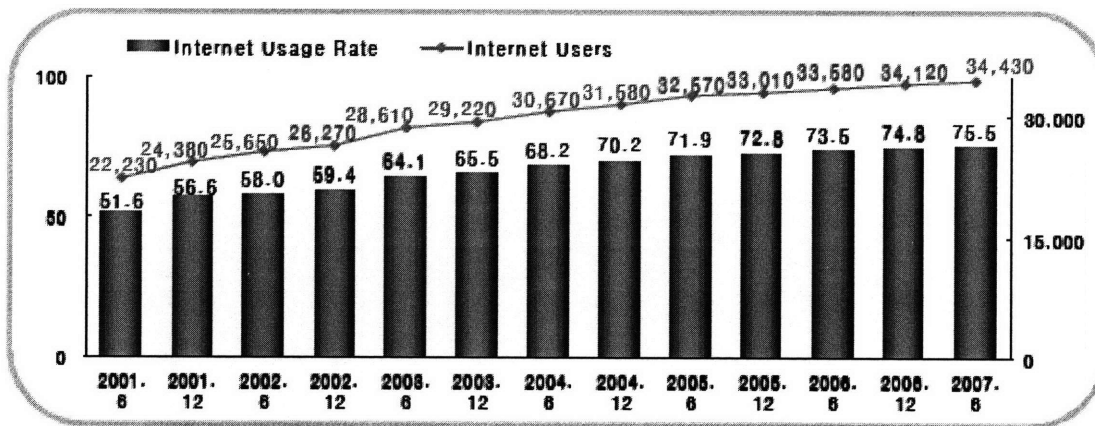
RAPID GROWTH: THE GOVERNMENT'S ROLE

The government deserves a lot of credit for South Korea's transformation from a technological laggard with less than one internet user per 100 inhabitants into the internet juggernaut that it is today. Several of the more successful government policies include:

- Pursuing liberalization within the telecommunications sector beginning in the early 1980's, with deregulation intensifying in the early 1990's as competition was

introduced incrementally for services. These competition-friendly policies eventually extended to internet services leading to relatively low prices and a subsequent rapid increase in demand.

- Spending billions of dollars in building a high-speed network linking government buildings and public institutions, particularly after the Asian financial crisis of 1997.
- Offering subsidies to telecom companies willing to build out high-speed connections to homes.
- Promoting computer literacy programs that approximately 3.4 million people attended.
- Marketing the internet as an essential learning tool, playing to South Koreans' zealous and often times competitive enthusiasm for education.
- Establishing well-publicized national goals that promoted connectivity, such as requiring all office and apartment buildings be given a broadband connection.

RAPID GROWTH: OTHER CONTRIBUTING FACTORS

South Korea also possesses certain unique qualities that have contributed to the rapid diffusion of internet services. The most significant of which are:

- More than 80% of the population lives in an urban area and apartments account for about 50% of the total housing stock, making the installation of broadband relatively easy.
- The immense popularity of internet gaming which has fueled the consumption of high-speed services, and the corresponding explosion in the number of PC "bangs" (rooms). According to a 2004 estimate by Forbes, nearly half of all South Korean internet users play online and fanatics are known to play for 10 hours or more at a time.
- Cultural characteristics such as the Korean collectivistic mindset and the social pressure to "keep up with the neighbors" have prompted many to purchase high-speed service.

THE EFFECTS OF UBIQUITY

The ubiquity of internet access has upended traditional South Korean society in a number of ways. Teenagers by the thousands, who often spend upwards of ten to twelve hours a day or more playing online games, have been treated for internet addiction. Singles, looking to escape the social expectations that they find oppressive when it comes to dating have used match-making sites for casual encounters or to find a romantic partner. Women homemakers, often physically and culturally restricted to the boundaries of their home, have been able to explore new interests and make new friends. Pornographers, aided by the anonymity of the internet, have successfully peddled adult content en masse, to the tune of about 200 billion Won in revenue in 2004 alone.

There's even a growing problem of cyber-mobs that track down and publicly vilify citizens or celebrities that they are unhappy with. The most famous victim of which is a female student, often referred to as "dog poop girl" by Korean bloggers, who had gotten off a subway car without cleaning her pet's feces. Unfortunately for her, she had been photographed by another commuter who posted the picture to a popular Korean website. Within days, she had been identified online and the subsequent public lynching resulted in death threats and humiliation, forcing her to quit school.

Perhaps the most important example of the internet's impact on South Korea, at least from a political perspective, is the last presidential election in which Roh Moo-hyun was elected on the back of an aggressive online campaign. Roh Moo-hyun was an unorthodox presidential candidate who came from humble roots, never went to college and did not have ties to South Korea's chaebols (major conglomerates). What he did have, however, was widespread support among South Korean youth. When exit polls on the morning of the election clearly showed Roh trailing his opponent, his supporters sent out hundreds of thousands of emails, flooded chat rooms and bulletin boards – all urging normally apathetic young South Koreans to go vote. Within several hours, Roh would take the lead and go on to a surprising presidential victory.

2. PROFILE OF SOUTH KOREAN USERS

In many ways, South Korean internet users resemble those that you will find in the States. Both South Koreans and Americans who live in higher income households are more likely to use the internet, as are those with higher levels of education or those who reside in an urban area. Moreover, both groups use the internet to chat, email, shop, view photos, watch videos and conduct research.

One difference of note, however, is that South Korean internet users tend to be younger. A 2001 study by Lee & Chan Olmsted, found that 90% of children and teenagers used the internet in South Korea in 2001 compared to 68.6% in the United States. Even more telling, only 8.7% of people over the age of 50 in South Korea used the internet in 2001, while a massive 37.1% did in the United States. It should come as no surprise then that South Koreans appear to engage in more entertainment activities (music, video, games) online than their American counterparts.

Internet Users by Age in South Korea (thousands) 2007
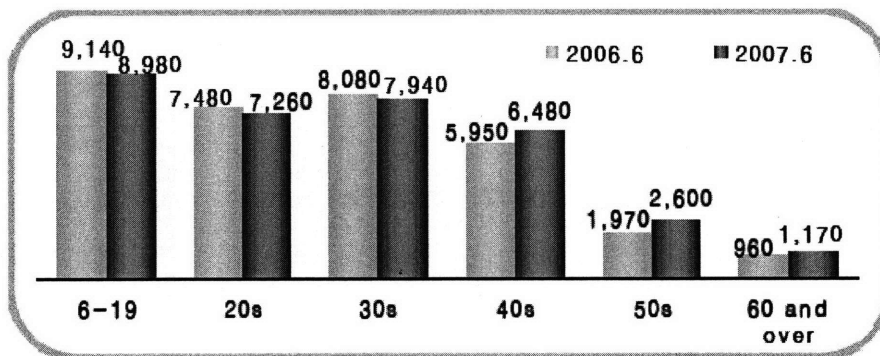
CONFUCIANISM AND CULTURE

Despite the liberalizing effect the internet has had on South Korea, traditional values still have a large effect on internet behavior. South Korea is a country heavily influenced by Confucianism, an ancient philosophy developed by early Chinese thinker Confucius, which provides moral and social principles of behavior. In fact, Confucian thought is so deeply ingrained in South Korea that it's known to shape every aspect of everyday life in

Korea, from marriages to relationships in the community to the way high-level business is conducted.

Confucian culture is defined by high power distance and collectivism. First, in a high power distance society, inequality among individuals with regards to status, power or wealth is expected and desired. Second, South Koreans' collectivistic mindset is reflected in close relationships with family members and a strong sense of identity with a larger "we" group. South Koreans are apt to sacrifice themselves for the greater good of their family, neighborhood or the nation as a whole. They are also likely to exhibit conformity and suppress personal preferences. Related, is the emphasis Koreans place on "saving face", which means not doing anything to embarrass yourself or your family.

Furthermore, like other Asian countries, South Korea is classified as having a high-context culture. High-context cultures are characterized by indirect and ambiguous communication as opposed to low-context Western countries where things are generally explicitly stated. People from high-context cultures usually send information implicitly and are usually well accustomed to interpreting messages in the context of a given situation.

INFLUENCE ON INTERNET BEHAVIOR

Given these cultural influences, it shouldn't come as a surprise that South Korean internet users exhibit certain behaviors that are different from what we expect in the United States. Chief among these are:

- South Koreans tend to visit the same few websites (Naver, Daum, Cyworld) for all of their online needs, regardless of whether it's for news, blogging, internet communities or sharing media. These websites are the most popular web destinations in South Korea and their share of internet traffic is only increasing, in a process that's usually referred to as "portalization". This is because South Koreans are inclined to trust well-known names and flock to websites that have established user bases.

- Much like in the offline world, social interaction and forming bonds are primary motivations for local users, as opposed to convenience or information gathering. This explains the wild popularity of web-based community services in South Korea.
- South Koreans are more trusting of, and interested in, information they can obtain from online interpersonal communication, such as from message boards or chat rooms.
- Korean users are generally more concerned about how their online identity and behavior are perceived by others.

3. CONSUMER INTERNET OVERVIEW

The consumer internet is very broad term that refers to all web destinations and services that an end-user, aka a consumer, might use. For the purposes of this paper though, I will limit my analysis to four of the most important categories in South Korea: portals, social-networks, user-created content and e-commerce. With the exception of online gaming, these sites account for the vast majority of web traffic in South Korea.

PORTALS

More than Just Search

Portals in South Korea wield a tremendous amount of power. South Koreans have always depended on portals for their search query needs, but recently a large and an ever expanding number are using portals for their entertainment/information needs as well. South Korean portals offer a host of media-focused features including blogging services, video-sharing and community forums. This has led to the portalization of the Korean web with the top portals enjoying continued user growth, whereas traffic at more specialized players has leveled off, or in some cases, even declined.

Case-in-point: the portals have surpassed newspapers as the primary provider of online news in South Korea. Daum, a major portal, saw the number of page views to its new service swell thirty-five fold from 110 million in July 2002 to 3.8 billion in July 2005. In the same time span, page views to the Chosun Ilbo, which has the most popular website out of all South Korea's local newspapers, fell from 690 million to 451 million. A 2005 study conducted by NAS Media confirms this trend. In a poll of 5000 South Korean internet users, a whopping 85.7% indicated that they obtain their news from portals, while only 10.3% stated that they look to newspaper homepages for their news needs. Left without any good alternatives, a majority of South Korean newspapers now submit their stories to the portals in addition to posting them on their sites.

All of these services are designed to drive additional traffic to the portals and in South Korea, internet users have come to expect a lot of "bells and whistles" on portal

webpages. It is an important realization that Yahoo, once the largest portal in South Korea in the late 90's, has had to adjust to. Failing to offer compelling services that could effectively compete with local offerings, Yahoo lost significant market share over the past decade to two homegrown rivals, Naver and Daum.

The Major Players

The two dominant South Korean portals are Naver and Daum, which together account for roughly 90% of all local search queries. Moreover, Korean Click, an independent internet market research firm, ranks Naver and Daum as the two most popular domains in South Korea in terms of unique visitors. It's no coincidence that both these portals have the most robust user features as well, as local search traffic seems to be inextricably tied to other web services.

Other search providers, both local (Empas) and foreign (Yahoo, Google), have negligible market shares (see graph below). In fact, one could argue that the internet search market is really a "one-man show" given that Naver accounts for 77% of all search traffic.
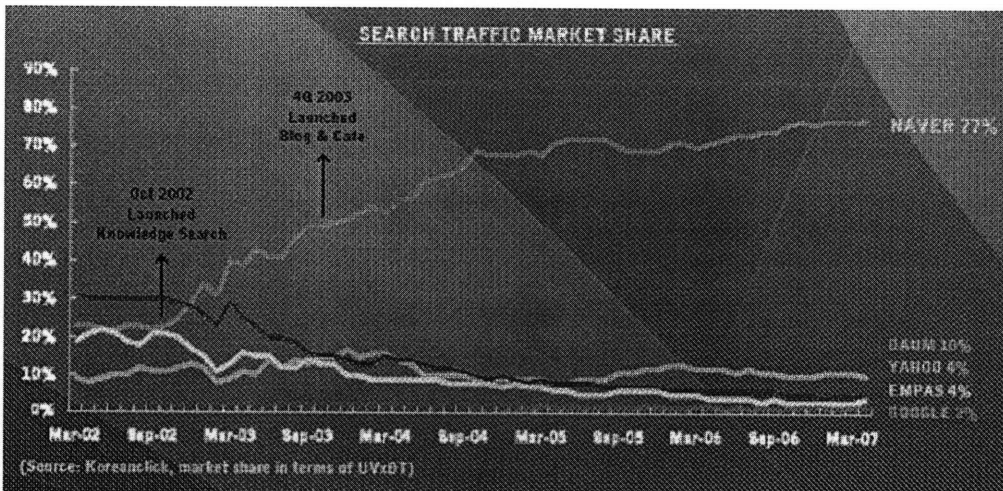
Google's Lack of Success

Globally, Google is the undisputed king of internet search, as its unrivaled search technology has allowed it to conquer local markets all over the world. Even South Koreans who prefer Naver or Daum will often admit that Google is better at archiving

webpages and retrieving information. Yet, in South Korea, its share of the search market stands at a miniscule two percent.

What has made success in South Korea so difficult for Google is that relative to other markets, there simply aren't enough sites to be indexed. For example, the number of web pages written in Korean is believed to have been around 50,000 in 1999. As Wayne Lee, an analyst at Woori Investment and Securities, points out: "No matter how powerful Google's search engine may be, it doesn't have enough Korean-language data to trawl to satisfy South Korean customers."

The Walled-Garden Solution

The solution for local portals has been to build walled-gardens of content on the web. For instance, Naver created a proprietary database of Korean language text by allowing users to ask and answer questions on everything from dating tips for college students to travel recommendations for recent retirees. This service, known as Knowledge iN, has accumulated more than 75 million user-generated entries to date and is growing at a rate of 44,000 new questions and 110,000 new answers per day. Just to put this number into perspective, Wikipedia has about 2 million entries domestically and about 7.5 million entries globally (albeit in a longer form). In addition, Naver also secures content by cooperating with various local media providers.

As a result, Naver is able to offer a more robust search experience in comparison to other search engines. A query on Naver will yield results from blogs, community sites, its own Q&A database and other non-traditional sources in addition to search results from web pages. For example, a Naver search for Kobe Bryant (코비 브라이언트) will return biographical information, blog stories, news stories, images, video clips, books about Kobe and various Kobe paraphernalia for sale.
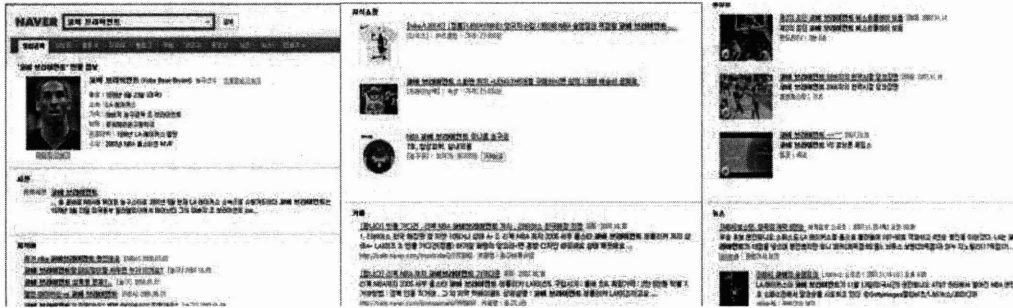
This approach has worked so well, in part, because it taps into the Korean desire to feel a sense of community. Finding information is obviously important, but what keeps South Koreans actively engaged is the type of human interaction that Naver's "Knowledge iN" platform provides. Moreover, asking users to contribute in this manner leverages South Koreans' strong cultural inclination to help one another online.

One potential drawback, however, is that because Korean portals have been so focused on their own walled gardens, they've ignored the plethora of English language content on the web. As more and more South Koreans become comfortable with English, there will likely be a growing number who will want to look beyond the Korean sphere in order to find more useful information. In this scenario, foreign firms (namely Google and Yahoo) will have a distinct advantage over their South Korean competition.

Outsourced Technology

As a matter of fact, neither Naver nor Daum operate their own search ad technology. Overture (Yahoo!) has an agreement with Naver to run their sponsored search listings for queries on the Naver portal and through the Naver toolbar. Sponsored search listings refer to advertisements related to query keywords that usually appear on top of, or to the side of, normal search results. These ads are usually all-text and include only a header and a brief description. Google has a similar arrangement with Daum.

Revenue

Much like portals in the States, portals in South Korea generate most of their revenue from search and banner/display advertising. For both Naver and Daum, ads account for approximately 90% of their total revenues.

Revenue Composition
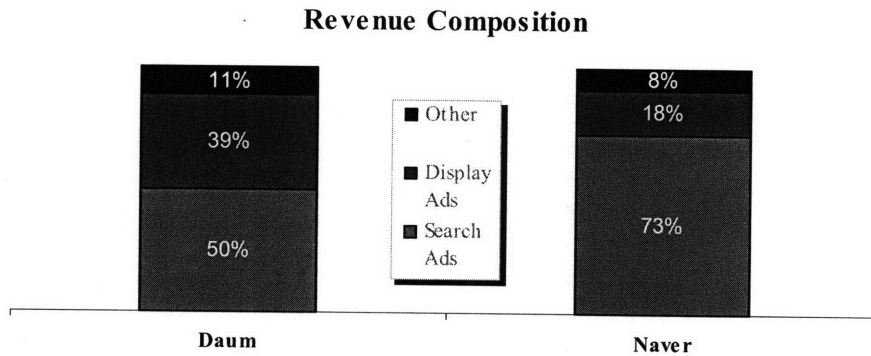
The consensus among analysts, including Wayne Lee of Woori Investment Securities, is that the outlook for online advertising is positive based on the view that "online ad sales will continue to expand at a steady rate." By Naver's estimates, the market for search advertisements will expand at a CAGR of 51% over the next two years, while the market for display advertisements will expand at a CAGR of 20%.

Cultural Misstep

Earlier this year a short pornographic clip was posted on Yahoo's video sharing service called Yammy. Over the course of six hours, about 20,000 people viewed the clip before it was finally noticed and removed by Yahoo employees. While an incident such as this would hardly be newsworthy in the States, it made headlines in South Korea and Yammy was closed amidst a heap of criticism from the local press. This case, among many others, illustrates the difficulty that foreign portals face navigating the cultural waters of South Korea.

Company Profiles: Naver and Daum

As mentioned previously, Naver is South Korea's most trafficked web portal and dominates internet search in South Korea much like Google dominates in most of the world. Given the limited size of the South Korean market, it should come as no surprise that Naver's 30M unique users pales in comparison to Google's 550M. That being said, Naver still ranks as one of the top five search engines worldwide according to comScore's inaugural report on worldwide search patterns. More importantly, Naver is far "stickier" than Google: Naver users visited an average of 33 times in February 2007 compared to only 24 times for Google. These results led comScore to dub Naver "the world's most engaging site."

Since being launched in June 1999, Naver has fueled the heady growth of its parent company, NHN. NHN is the most profitable internet company in South Korea and a star-performer on Korea's primary tech stock exchange, the Kosdaq.

Daum is South Korea's second most popular web portal and Naver's chief competitor. Founded in 1995, Daum actually preceded Naver and was the first Korean portal of any relevance. Daum achieved success early on with well-received launches of its leading email service, Hanmail.net, in 1997 and its popular community service (community services are internet forums where groups of users gather around a particular interest or topic), Daum Café, in 1999. These successful product introductions helped catapult Daum past Yahoo! Korea in the early part of the decade as the top-ranked web portal.

Over the last couple of years, however, Daum's share of search queries has hovered around 10% and recent data suggests that its prospects for taking away significant traffic from Naver seem bleak. Perhaps more importantly, Daum no longer dominates in community services, arguably Daum's trademark business. The number of visitors at Naver Café (Naver's community service), 14.6 million, exceeded the number of visitors

at Daum Café, 14.4 million, for the first time this past June. On the bright side, Hanmail clearly remains the country's email service of choice, with 38 million out of 49 million South Koreans having accounts, and Daum's video service is currently outperforming Naver's.

SOCIAL NETWORKS

In the US, the social networking space is very competitive with MySpace, Facebook, Bebo, LinkedIn and a host of others vying for users. In South Korea, however, there is only one real player and it's Cyworld. For all practical purposes, Cyworld is a social networking monopoly; it has over 20 million subscribers representing approximately 40% of the total population. More impressively, over 90% of twenty-somethings are said to use Cyworld "regularly". By comparison, MySpace (known to pad its numbers with inactive or fake accounts) and Facebook have about 105 million and 69 million users respectively (as of August 2007), representing about 35% and 23% of the US population.

Cyworld wasn't the first noteworthy Korean social network, however, as that distinction belongs to online alumni network "I Love School". Somewhat akin to Facebook, I Love School connects graduates from a given elementary, middle or high school to each other and for a brief period starting in the late 90's, it was the most popular social networking service in South Korea.

Company Profile: Cyworld

Like all social networks, Cyworld allows its users to create customized homepages and form online connections that reflect their offline relationships. Cyworld residents can also upload and share photos/videos (a big driver of traffic), create and join clubs (communities), send and receive messages, write a blog (called a "paper") and express their individuality by adding skins, background music, etc. All of these features exist in a user's "minihompy", short for minihomepage.

Minirooms

Cyworld's distinguishing feature, however, is the "miniroom". A cross between a virtual world and a profile page, minirooms are three-dimensional spaces where a resident's cyberspace avatar lives. New users are initially given an empty room that they can

subsequently choose to furnish with cyber friends, banners, pixilated furniture and even virtual appliances. Currently, there are about 400,000 items to choose from and many of these are limited edition. To pay for these digital items, users must exchange real world money for "dotori" (acorns), which is the currency in Cyworld.
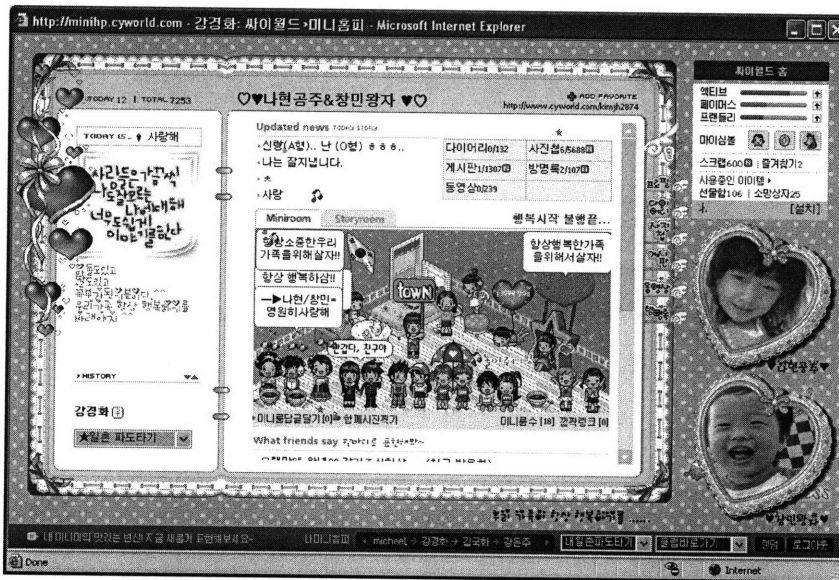
Interestingly, there is a fair amount of social pressure to have an alluring, visually appealing miniroom that you can show off to your friends and family. The more interesting a room is the more visitors it is likely to attract and in South Korea, Cyworld popularity often translates into real world popularity. In order to encourage sales, Cyworld tracks the number of digital items a resident sends or receives as gifts in order to measure their sexiness and friendliness. The most active residents are known to spend several hundred dollars or more decorating their minirooms.

Other Key Attributes

- Cyworld requires users to submit their national identification number, the South Korean equivalent of a social security number, as a prerequisite of service. This has allowed Cyworld to avoid some of the problems with predators and abusive behavior that have plagued US social networks.

- Compared to sites like MySpace, which are relatively open to modification and third-party functionality, Cyworld has taken a decidedly walled-garden approach as a means of quality control.
- Launched in March 2004 (almost three years before Facebook), mobile services are a big driver of traffic and revenue for Cyworld. Everyday users upload photos, send messages and check what their friends are up to – all from their mobile phones.

Cultural Contributions

Korean culture has played an important role in Cyworld's success. As a community-oriented people, South Koreans always like to know what others are up to and Cyworld has enabled them to do just that. In addition, visitors to a Cyworld user's minihompy will often leave a message greeting their friend and letting them know they stopped by. Social customs dictate that each message receives a timely response and not doing so can be viewed as rude and offensive. Not surprisingly, this can lead to a seemingly never-ending cycle of messages being sent back and forth between friends.

Revenues

A subsidiary of SK Communications, Cyworld reportedly earned $12.5M in profit in 2005 on revenue of $110M. The bulk of Cyworld's revenue comes from the sale of virtual items (worth $300,000 per day) that residents use to decorate their minirooms and not from advertising, which is unusual for a social network. In fact, personal mini-homepages carry no advertising whatsoever – although banner ads are placed on public spaces such as Cyworld club pages. It's also important to note that Cyworld pays anywhere from thirty to fifty percent of the proceeds from the sale of a particular item to the creator, typically a graphic design shop.

Growing sources of revenue for Cyworld are mobile services, through which 2.6M customers pay to upload photos from their mobile phones, and music services, though which Cyworld sells six million songs a month to users who want to stream music on their mini-homepages.

Competition

There are early warning signs that Cyworld's popularity might be waning however. The number of monthly visitors has peaked at twenty million – unchanged since April 2005. More concerning is the fact that the average monthly site time per user has declined to four hours and twenty-one minutes in February 2007 from six hours and forty-eight minutes in July 2004. As Shim Jun-ho (analyst at Goodmorning Shinhan Securities) explains, "SK Communications, which operates Cyworld, may worry about the plunging median use time because it can signal a loss of loyal customers."

It's not clear what sites are directly benefiting from Cyworld's woes, but many speculate that it's the portals (Naver, Daum) and video-sharing services. Both Naver and Daum have recently launched new web 2.0ish blogging services that directly compete with Cyworld's mini-hompy. Furthermore, MySpace and Facebook announced just last month that they intend to make an aggressive push into the Asian markets, of which South Korea is obviously a part.

UCC: USER-CREATED CONTENT

The buzz word of the moment for South Korea's internet industry is UCC, or user-created content. UCC refers to content produced by end-users as opposed to copyrighted content published by professionals. It also reflects a shift in the way the public engages with online media; South Koreans are now active creators of digital content as opposed to simply being passive consumers. In a poll conducted by the Ministry of Information and Communication this year, a surprisingly high 51.1% of respondents indicated that they had created UCC for themselves.

Over the past few years, it is user-created content that has driven much of the growth in web traffic in South Korea. For instance, the number of blog postings has multiplied by a factor of ten from 2005 to 2007. Uploads of short video clips have increased most dramatically, however, with Pandora TV (the nation's largest online video site) experiencing a 1000% increase in the number of visitors to its website in one year (2005) alone. Perhaps as a result, conversations in South Korea about UCC are typically centered on video-sharing.

Many Types of UCC

There are many different types of web 2.0 companies in South Korea that operate under the broad umbrella of user-created content. Some of the more prominent include:

- Revu is a customer review site that allows users to sort by a reviewer's online reputation.
- Ohmynews is an online newspaper that is written almost entirely by bloggers and other freelance contributors. Ohmynews is often credited with pioneering "citizen journalism".
- Enbee is a photo-sharing site that also offers photo-printing services.

Online Video

Online video is by far the most popular form of user-created content, however. Amateur-made video is now ubiquitous in South Korea and video-sharing sites are competing to stockpile as many video clips as possible

Korea's Online Video Service Traffic Trend
(Source: KoreanClick)
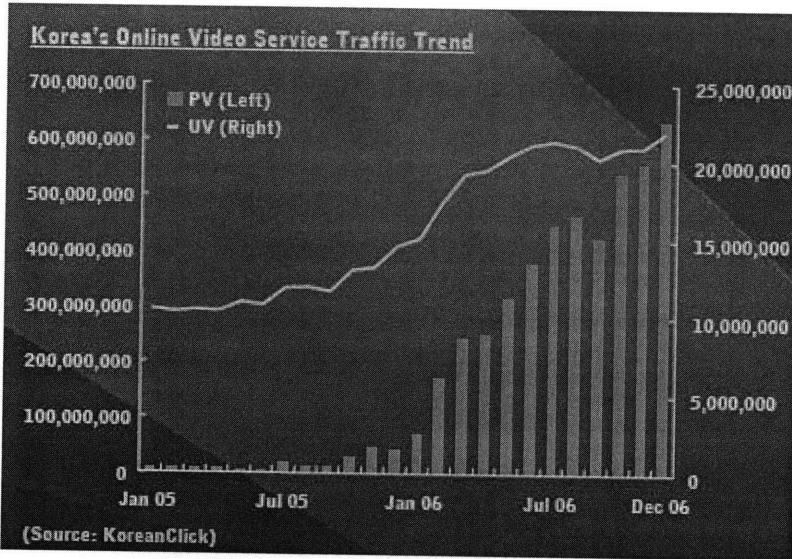
Predictably, most of this user-created content is either controversial or idiosyncratic in nature. The most watched video last year was of a group of middle-school girls taking one of their classmates hostage and beating her mercilessly. This clip was viewed 1.15 million times in twenty-four hours. Other popular videos included clips of a man overcoming cerebral palsy to become a pianist and a girl setting her dog afloat by tying balloons to its legs.

The leading independent video-sharing service is Pandora.TV, but others such as mncast.com and gomtv.com attract significant followings as well.

Unique Visitors per Hour
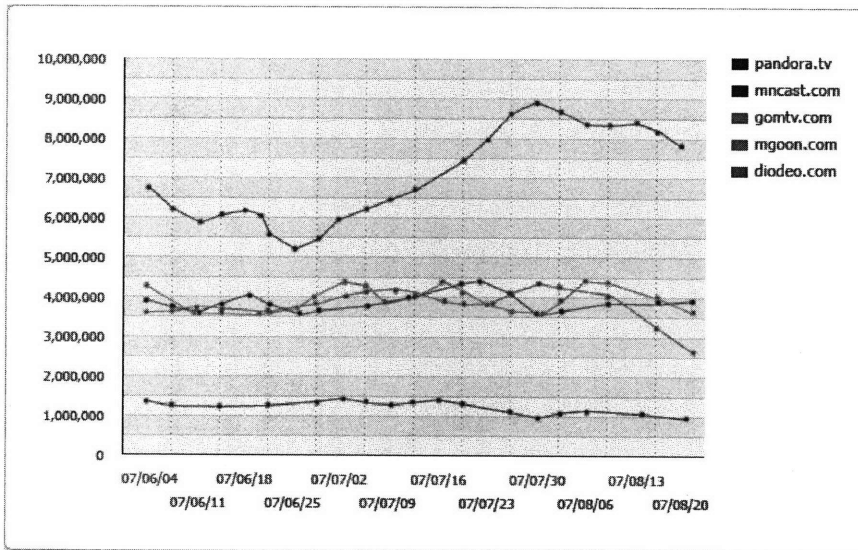
Competition

It should not come as a surprise that the biggest threat to video-sharing companies is the portals. Naver and Daum have been building out their video platforms and devoting more resources to generating revenue from user-created content. So far, their efforts have been well received as visitors to video sharing services at major portal sites more than quadrupled between March 2006 and March 2007.

Additional competition is expected to come from YouTube, which announced plans to launch a Korean language site in the near future and unlike Google, YouTube is expected to enjoy some success in South Korea. As Kang Rok-hee, an analyst at Daishin Securities, points out, "YouTube has a shot at making inroads as video clips are different from search services; they are not so vulnerable to cultural differences".

Company Profile: PandoraTV

Since its inception in October 2004, almost five months before YouTube was founded, PandoraTV has quickly grown to become South Korea's top internet video destination

both in terms of monthly unique visitors (15 million) and monthly page views (2 billion). Users upload about 10,000 new clips of varying length and file size everyday, taking advantage of Pandora's unlimited storage space. Aside from traditional video sharing services, however, Pandora also allows its users to create personalized television stations around a particular theme or interest and to run live video casts/shows. These channels can often serve as a focal point for friends or like-minded users to chat and interact with one another.

Similar to most consumer internet sites in South Korea, Pandora can be accessed from a computer or a mobile phone. Pandora is also the first South Korean firm to raise two rounds of funding from Silicon Valley venture capitalists.

Business Model

Pandora's business model is primarily centered on advertisements just prior to the start or just after the completion of a video clip (pre-rolls or post-rolls). It claims the average click-thru-rate on these ads is about two percent. In addition, Pandora generates revenue from brand channel sales, whereby businesses purchase a channel for commercial use, and from content distribution fees.

E-COMMERCE

South Korea's e-commerce market is already sizeable by Asian standards. Total internet sales have more than quadrupled from 3.3 trillion won in 2001 to 13.45 trillion won in 2006, and the average South Korean internet user spent 391 thousand won ($408) online buying goods, up from 323 thousand won ($315) in 2005. Furthermore, as recently as three years ago, eBay generated upwards of 75% of its revenues from South Korea.

Despite such strong numbers, there still seems to be plenty of growth left for the Korean e-commerce market. As Deutsche Bank analyst Jeetil Patel points out, online retail as a percentage of offline retail is believed to have been only six percent last year. He also predicts that the market, as measured by cumulative sales, will almost double by 2010 (from 2006).

Demographics and Purchasing Behavior

Data from the National Development Agency of South Korea (NIDA) indicates that in June 2006, 51.3% of internet users ages twelve and over purchased good online during the preceding twelve months. Of this group, women were more likely to buy than men and twenty-somethings were more likely to buy than any other age group. The data also reveals that their primary reasons for shopping online were to compare product information (84.3%), find cheaper goods (68.9%) and save time (48.8%).

% of Internet Users in Each Category who Purchased Online

Gender	
Male	46.0%
Female	57.6%
Age	
12-19	41.9%
20-29	72.2%
30-39	59.2%
40-49	37.9%
50-59	24.0%
60+	9.8%

Note: *Internet users ages 12+ who made an online purchase in the past 12 months
Source: National Internet Development Agency of Korea (NIDA), July 2006

080044   www.eMarketer.com

Clothes were the most popular item for sale online in 2006 (accounting for 17.6% of all transactions) followed closely by travel services (15.0%) and electronics/appliances (14.9%), as reported by South Korea's National Statistics Office.

Cultural Differences

South Korean internet shoppers are quite different than their American counterparts. For one, they tend to rely far more heavily on friends and family when making purchase decisions, as would be expected in a collectivistic society. For another, they are much more apt to utilize online discussion boards, both as a point of reference and as a channel to provide feedback to the online retailer.

Moreover, these cultural differences have important managerial implications, as described by Teck-Yong Eng and Eun Jin Kim in their study of e-customer loyalty (2006). In South Korea, group communication is far more effective than one-to-one marketing, provided that the communication is targeted to differentiated homogenous consumer segments. In addition, given the value that South Koreans place on the opinions of others, it is important for online retailers to encourage their customers to post timely comments and feedback, perhaps by offering incentives such as price discounts.

The Rise of Auction Sites

Online shopping in South Korea is generally conducted at internet shopping malls. The first malls, which operate by providing online space and payment services, opened for business in 1996 and were primarily affiliated with well-known brick and mortar shopping malls. These days, however, online auction sites that enable buyers and sellers to transact directly, control most e-commerce business.

Company Profiles: Internet Auction and Gmarket
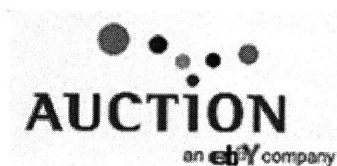
Internet Auction (also known as simply Auction) and Gmarket are the two leading e-commerce/auction websites in South Korea and are currently engaged in a fierce battle for internet shoppers. Auction was once the dominant player in South Korea, but it has lost considerable market share to Gmarket over the last few years. Recent data from KoreanClick puts the number of unique visitors in October at 18.96M for Auction and 17.96M for Gmarket.

While both retailers offer consumers a vast array of items for sale and derive revenues primarily from transaction fees that vary depending on the product, there are distinct differences in their market strategy. Auction, much like its parent company eBay, focuses on large businesses (otherwise known as power sellers) by giving them preferred listings and visibility. Gmarket on the other hand, targets its services to small to medium sized businesses and places less emphasis on an open auction format than Auction, instead offering goods at fixed prices with the option to negotiate with a seller on an exclusive basis. Gmarket also caters to South Koreans' preference for in-season fashion items and comparison shopping, a particularly smart decision in hindsight. In recent months, Auction has been able to regain some market share by incorporating several of Gmarket's tactics, using aggressive marketing and reducing commissions.

Korean E-Commerce - GMS breakdown (in billions Korean Won)

28
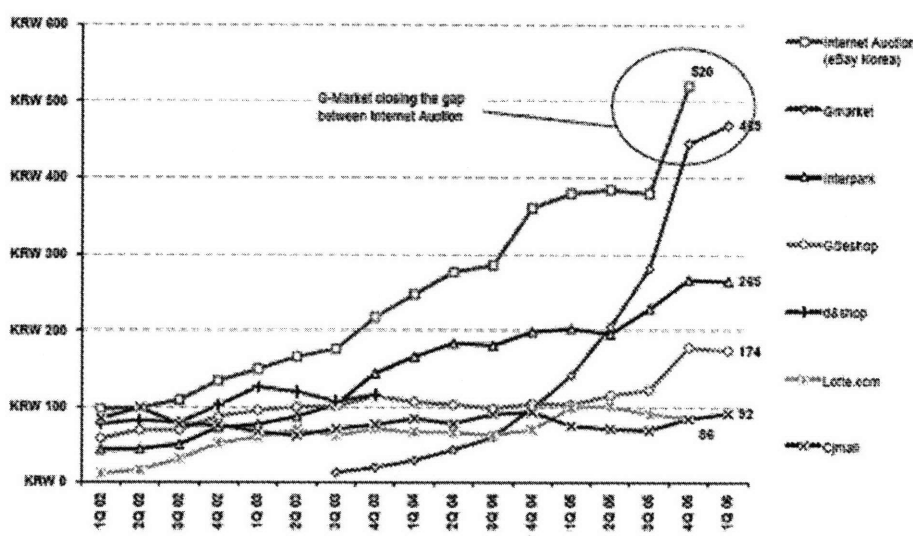
4. SHORTCOMINGS

To a casual observer, South Korea might appear to be a consumer internet utopia, where innovation flourishes and new ideas are cultivated in a cradle of high-speed networks and private sector support. This assumption would be wrong. For all that the consumer internet in South Korea is, there are many things that it is not.

LACK OF INNOVATION & ENTREPRENEURSHIP

Most notably, there is a conspicuous lack of innovative, new web services. South Korea's technological prowess stems primarily from its telecom infrastructure and capabilities in producing electronics, not from consumer internet-oriented businesses. Although companies such as Cyworld and I Love School definitely deserve credit for being ahead of their time, they were both founded last decade. Furthermore, nearly all of the truly ground-breaking South Korean services were released more than five years ago. These include Hanmail (1997), Daum Café (1999) and Naver Knowledge iN (2002).

Part of the problem is certainly the portalization of the Korea web as described earlier. The dominance of the portals has become so pervasive that key industry veterans, like TJ Kim (CEO of online gaming company NC Soft), have begun to claim that the portals are stifling innovations.

Perhaps more importantly, however, South Korea lacks a fertile entrepreneurial ecosystem. You rarely hear stories about students, with little more than an idea and a dream, dropping out of school to start a new venture (think Google, Yahoo, Apple, Facebook, etc.). Instead, South Korea's best and brightest typically devote their time preparing for a job at a chaebol or government agency that offers security and respect within the community. The willingness to take risk and "chutzpah", both key attributes for an entrepreneur to have, are simply not valued in South Korean society. It's the unfortunate byproduct of a collectivistic culture that emphasizes "not rocking the boat" and "saving face".

HOMOGENOUS INTERNET USE

South Korea has been criticized for having internet monoculture, meaning that almost everyone uses the same applications/products in the same way. Over 99% of internet users are on Microsoft Windows and use Internet Explorer. Linux, Mozilla Firefox and Apple users can not bank or make purchases online because all encrypted transactions must be performed with Active X controls. Non-MS browsers can not even interact with South Korean government agency web pages, since they too, run Active X controls. The issue lies with how official certificates, necessary for many online services, are issued by authorities. In response, Open Web, a non-profit organization dedicated to fair internet practices, announced earlier this year that it is suing the South Korean government for its implicit and anti-competitive endorsement of Microsoft products.

SCARCITY OF VENTURE CAPITAL

Relative to the US and other emerging nations like China or India, South Korea suffers from a scarcity of venture capital. Raising early-stage money can prove to be an arduous task and bootstrapping is often the only viable option.

5. CONCLUSIONS

OPPORTUNITIES EXIST

Despite the many obstacles to building a successful internet business in South Korea, ample opportunities definitely do exist for well-managed foreign competitors, regardless of whether they are startups or established corporations. The insular nature of the Korean web can not possibly continue for much longer as the rest of the world moves toward open platforms and as South Koreans become increasingly more aware of the greater cyber-universe around them. In this respect, foreign firms with better technology (Google), better access to capital (Microsoft) or better knowledge of open standards (Facebook) will have a distinct advantage.

What's more, practical applications (Digg, del.icio.us, StumbleUpon) and social sites that target specific verticals (LinkedIn, Flixster) have yet to gain traction in South Korea. Assuming that the trend toward portalization dissipates or levels off, it's probably a good bet that the popularity of such web pages will increase in the near future. And at the very least, South Korea, with its internet savvy residents, will remain an important market in which to test new products and services for the foreseeable future.

BUT THERE IS A LARGE CULTURAL GAP

It's imperative that any company doing business in a foreign country learn the local culture and customs, but this is particularly crucial in South Korea. For better or for worse, South Korea is known as being a "graveyard for global top-tier firms". Google is but one example. Wal-Mart, Nokia and Nestle are other companies that are number one in their respective industries, but that have been unable to achieve meaningful results in South Korea. The common theme is a failure to adequately translate business practices and products to South Korea's somewhat idiosyncratic tastes.

For consumer internet companies, making sites more community-friendly by adding message boards/chat rooms is a step in the right direction. Other ways to address the culture gap include hiring South Korean executives with local expertise and forming

partnerships with established domestic players. Specifics measures will vary for each firm, but as a general rule, foreign internet companies should focus on ingratiating themselves into South Korean life as quickly and as thoroughly as possible.

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