

Korean tech is losing its cool

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How Korea, a onetime digital trendsetter, became a laggard in an era of smartphones—and amazing apps.

For more than a year, Bae Jae Hyun wondered why her friends were so excited about the iPhone. She was happy with her Korean-made handset and puzzled by the desire for a phone that wasn't even available in the country. But when the iPhone arrived in Korea in November, it didn't take long for Bae to change her mind and buy one. "I now understand why they were so obsessed with it," says the 22-year-old student.

In December, Koreans bought some 200,000 iPhones—the best month ever in Korea for any handset model. In a country where domestic giants Samsung (005930:KS) and LG (066570:KS) together control 80% of the cell-phone market, that's quite a coup for Apple (AAPL). "The iPhone is so much better than any Korean phone I've ever seen," says Kim Ho Heok, a schoolmate of Bae.

The iPhone's popularity is a sign that Korea may be losing its edge in the international market, despite its reputation as the epicenter of digital cool. The country still rules in hardware, but it is stumbling in software. Samsung and LG, the No. 2 and No. 3 global handset makers, together manufactured nearly a third of the world's mobile phones last year, but their share of the smartphone market was just 4%. That's important because smartphones offer greater profits than traditional handsets, and they are increasingly popular with customers. The Koreans have rolled out models featuring touchscreens, high-resolution cameras, and TV. But they're often clunkier to use than rivals from Apple and Research in Motion (RIMM), maker of the BlackBerry.

Korea's software shortcomings are of growing concern to the country's political and business leadership. On Feb. 4, President Lee Myung Bak convened a special Cabinet meeting to address the issue. Ministers were told the country accounts for only 1.8% of the world market for software of all kinds, even though it dominates sales of memory chips, liquid-crystal displays, and flat-screen TVs. While Samsung sold 227 million handsets last year—10 times as many as Apple—its earnings were lower because its profit margins are much slimmer. "The government had been preparing to shift our focus to software from hardware for about a year, but the iPhone sensation provided a wake-up call," says Lee Sang Jin, who oversees the software division at the Ministry of Knowledge Economy, known until two years ago as the Ministry of Commerce, Industry & Energy.

"The Policy Backfired"

Seoul, which has long played a big role in guiding important industries, has launched a state-funded program to nurture software startups. The Ministry of Knowledge Economy is budgeting some \$880 million to back software companies over the next three years. It aims to double the number of Korean software engineers to 300,000 in 2013 from 2008 and triple software exports to \$15 billion.

A previous government attempt to boost the software industry was something of a dud. Seoul in 2005 required handset makers and content providers offering products or services in the country to use a Korean technology for Internet access instead of the programs used in most other countries. The rule was rescinded last year, but it clearly slowed the foreigners: The iPhone hit Korea more than two years after its U.S. debut. The downside is that Korean software writers were left with programs that worked only in their home market. As a result, they received scant exposure to the rigors of the global marketplace. "The policy backfired for

Korea by stopping competition for innovation," says Chung Tai Myoung, an engineering professor at Sungkyunkwan University.

Software successes

Samsung and LG say they intend to expand their smartphone lineups and offer more applications to run on them. "We have tremendously strengthened our software, which has been our weak spot," says J.K. Shin, president of Samsung's handset business. On Feb. 14, Samsung unveiled a software platform called bada ("sea" in Korean) to let outside developers create programs for its devices. And LG last December set up a unit with more than 800 programmers focused only on smartphones. This year the company expects to introduce about a dozen models using Google's (GOOG) Android operating system. "We are trying to offer more than the iPhone," says Skott Ahn, LG's mobile phone chief.

Despite the government's software worries, Korea has had some notable successes. Lineage, an online fantasy game made by Seoul-based NCsoft, has a cult-like following across Asia. Social networking service Cyworld, which was launched earlier than Facebook, is dominant in Korea. After eight years of offering Korean-language search, Google has just 2% of the market, compared with 64% held by Naver, headquartered in a Seoul suburb. And Qualcomm (QCOM) on Feb. 1 announced plans for a research center in Seoul to work on multimedia applications. "We see great potential in Korea," Qualcomm Chairman Paul E. Jacobs said at the time.

Yet when it comes to smartphones—perhaps the most important new sector in the technology business—young Koreans don't expect much from homegrown alternatives to Apple or BlackBerry. "I don't think I'll want a Korean phone in the next few years," says Yoon Ju Hwan, a 30-year-old fund manager who bought an iPhone in December. "We simply don't have the capabilities to create the kinds of things Apple does."

Fonte: BusinessWeek. Disponível em: <www.businessweek.com>. Acesso em: 19 fev. 2010.