

Business Risk and Ethics in Prospective Emerging Markets: The Case of Sports Sponsorship in North Korea

Sven Horak

Structured Abstract

Article Type: Case study

Purpose— This article discusses ethical issues of doing business with the Democratic People’s Republic of Korea (North Korea) and associated risks in the area of sports sponsorship.

Design/methodology/approach— Ethical questions influence an international firm’s engagement in North Korea in significant ways. Starting from a theoretical anchorage in business ethics, I apply descriptive case study methodology based on media analysis in order to understand ethical challenges of business management with North Korea by the example of firms from developed economies and emerging economies. This article is suitable to be used as a teaching case in international business and management classes (teaching notes are available on request from the author at sven.horak@gmx.de).

Findings— The study leads to three major propositions. International investors may benefit from first mover advantages in the area of sports sponsoring. On the contrary, breach of contract risks are high and a doubtful image of the sponsoring firm may be created in the eyes of the consumer while sponsoring a dictatorship. Moreover, the article finds indications that business transactions between two emerging markets appear to be smoother than between emerging markets and developed economies.

The Peter J. Tobin College of Business, St. John’s University, 8000 Utopia Parkway, Queens, NY 11439, USA; sven.horak@gmx.de



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Originality/value— Only a few international firms are maintaining business relations with North Korea. If the new leadership opens up the country for international investors as proclaimed, international firms need to understand the prevailing business environment. In this context, the link between business ethics and associated risks has been rarely discussed since leadership change in 2011.

Keywords: business ethics, business risk, emerging markets, North Korea, sponsorship, sports

Introduction

Since the death of Kim Jong-il in 2012, the international media has speculated whether the new leader, his son Kim Jong-un, will put economic development on his political agenda and open up the North Korean economy for foreign investors. In his new year's speech held in 2013, Kim Jong-un called for far-reaching reforms in the following year including an opening up of the economy to foreign investors and achieving better relations with South Korea.¹ While skepticism remains as to whether an economic opening can be achieved in the short term, potential foreign investors need to focus on business opportunities and market attractiveness.

While not yet being considered an emerging market by the major indices,² the popular media ascribe the country basic potential to become an emerging market in the future due to its relatively large domestic market, with its population of 24 million inhabitants and due to its richness in natural resources (e.g., gold, silver, copper, magnesite, coal, uranium and iron ore). If economic reform takes place, Goldman Sachs, for instance, sees enormous growth potential in the North Korean economy.³ The bank's analysis of the North Korean economy assumed the value of domestic mineral resources at 140 times of the 2008 gross domestic product (GDP). However, the country has a relatively young and technologically educated labor force which is available at low labor costs of around USD 160 per month.⁴

A comparatively small but increasing number of international investors have already ventured into business with North Korea. The Cairo-based firm Orascom established the first GSM mobile phone network there in 2008 and contributed to funding the construction of the 105-story Ryugyong Hotel, located in the capital, Pyongyang, that is planned to open in 2013 and which will be managed by the Swiss luxury hotel group Kempinski Hotels.⁵

If North Korea fully opens up its economy to foreign investors, the business opportunities will be plentiful.

The Ethical Dilemma Situation

Despite potentially lucrative business prospects, international investors are at the same time faced with ethical dilemmas and substantial business risk when intending to invest in North Korea. From a theoretical point of view, ethics in business used

to be defined as “behavior that is consistent with the principles, norms, and standards of business practice that have been agreed upon by society.”⁶ But what if society is not free to participate in political decision-making processes but is instead oppressed by a dictatorial leadership, as is the case with North Korea (more details will be provided in the further course of the study)? How should foreign investors respond to such an environment? Engage in business activities and risk receiving bad press that may cost them consumers in the firm’s home country?⁷ Theoretically it is assumed that a country which violates human rights, in which legal arbitrariness prevails, in which corruption is high and which lacks predictable rules in business does not attract foreign businesses and remains economically backward.⁸ Firms usually weigh chances, risks and ethical concerns in order to benefit from first mover advantages or to skip a venture in emerging markets.⁹ As this case will show, levels of tolerance towards ethical issues differ among countries that show an interest in doing business with North Korea.

It has to be noted that research on North Korea is inherently difficult. Data availability and data credibility are typical problems. However, as foreign firms are already engaged in sponsoring North Korean athletes and media started reporting about those experiences, a decent base of information is made available in order to discuss ethical dilemma situations in international business. This is of particular value for research aiming at practical relevance and implications for managers.

Achievements and International Recognition of North Korean Athletes

The North Korean sports industry is one of the sectors which is attractive to international investors since on the one hand it lacks financial resources, but on the other hand it has achieved international recognition ever since the soccer World Cup in England in 1966 when the North Korean team beat Italy 1–0 and made it to the quarter finals. From that year onwards, North Korean athletes have frequently participated in international tournaments and have received international recognition (see table 1).

Nevertheless, as North Korea is governed by totalitarian rule, sponsorship decisions can hardly be detached from a consideration of the political environment. The following section provides a brief summary of the facts international investors have to consider.

Country Overview and Background Information

While not officially ending the war, the Korean War Armistice Agreement signed by South Korea and North Korea in 1953 resulted in a cease-fire agreement between the two countries which has lasted until today. Since the establishment of North

Table 1: North Korean Participation in International Tournaments (selection)

YEAR	TOURNAMENT	VENUE	DISCIPLINE	ACHIEVEMENT
2012a	World Ice Hockey Championships	Finland, Sweden	Ice Hockey (male)	42nd place
2011b	FIFA World Cup	Germany	Soccer (female)	Qualified/ group stage
2010c	FIFA World Cup	South Africa	Soccer (male)	Qualified/ group stage
2008d	AFC Women's Championship	Vietnam	Soccer (female)	Winner
2007e	FIFA World Cup	China	Soccer (female)	Quarter Finals
2004f	World Ice Hockey Championships	Czech Republic	Ice Hockey (male)	34th place
2003g	FIFA World Cup	U.S.A.	Soccer (female)	Qualified/ group stage
2003h	AFC Women's Championship	Thailand	Soccer (female)	Winner
2001i	AFC Women's Championship	Taiwan	Soccer (female)	Winner
1999j	FIFA World Cup	U.S.A.	Soccer (female)	Qualified/ group stage
1966k	FIFA World Cup	U.K.	Soccer (male)	Quarter Finals

Note: FIFA: Fédération Internationale de Football Association (International Federation of Association Football), AFC: Asian Football Confederation

Sources:

- <http://www.iihf.com/iihf-home/history/past-tournaments.html>
- <http://www.fifa.com/womensworldcup/organisation/media/newsid=1470844/index.html>
- <http://www.fifa.com/worldcup/archive/southafrica2010/teams/team=43821/index.html>
- <http://www.rsssf.com/tablesa/aswomen.html>
- <http://www.fifa.com/associations/association=prk/goalprogramme/newsid=533118.html>
- <http://www.iihf.com/iihf-home/history/past-tournaments.html>
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- <http://www.fifa.com/worldcup/archive/edition=26/overview.html>

Korea in 1948, the country has had three leaders from the same family: Kim Il-sung (1948–1994), his son Kim Jong-il (1994–2011) and his grandson Kim Jong-un (the incumbent since 2011). Though officially a “Democratic People’s Republic,” in practice North Korea is a totalitarian single-party state, dictatorially ruled by the Kim family through the Korean Worker’s Party. Political ideals initially related to Soviet communism, but were later on exchanged for the *Juche* ideals,¹⁰ a uniquely North Korean ideology, placing self-reliance in all aspects of state governance in a central role.

Though the North Korean economy initially performed comparatively well under the communist system during the 1960s, the situation worsened thereafter.¹¹ Since North Korea maintained trade activities with the Eastern Bloc states as a member of the Council for Mutual Economic Assistance (CMEA, 1949–1991), led by the Soviet Union, its economy almost broke down with the disappearance of CMEA activities

following the fall of the Soviet Union in 1991. From that time onwards, the state has been fighting for survival. The problem of food supply is critical and the famine during the 1990s caused an estimated 800,000 to 3 million deaths. The major reason why the North Korean regime has not yet collapsed can be seen in the country-wide repression and control systems that oppress civic uprisings. There is neither freedom of speech nor freedom of religion.¹² Human rights are heavily violated. Critical voices are eliminated.¹³ There are concentration camps (gulags) where people suffer forced labor, torture and death. Executions for misconduct are reported even for small “crimes” such as watching foreign TV shows and DVDs that are forbidden in North Korea.¹⁴ In international indices comparing, for instance, press freedom, democracy, corruption perception and economic freedom, North Korea occupies the last rank, and it frequently provokes transnational and international disputes.

Citizens are practically under permanent exposure to political propaganda and surveillance by the police, security forces and undercover informants of the police. The security apparatus is said to have an overlapping organization, so that units monitor one another without knowing it. The arbitrariness of police forces is also reported. Another major tool preventing a state collapse is elite co-option. Those officials belonging to the elite circle are granted more freedom, provided with luxury goods and better food, and enjoy other privileges.¹⁵ Things got worse in North Korea after the fall of communism in 1991, due to the famine in the same decade, with mass starvation, government suppression, violence, inhuman actions and murder; several observers expected a state collapse to take place soon. It is astonishing that it has not taken place yet.

Given the situation which has been described, it is no surprise that legal law enforcement for private firms is weak. Business contracts are often violated and superseded by leadership decisions, representing a risk to foreign investments.¹⁶ Comparing the acknowledged business risk rankings of the Belgium Export Credit Agency (ONDD) and the Organisation for Economic Co-operation and Development (OECD), North Korea appears to be one of the most risky countries to do business with (see tables 2 and 3).

Despite these problems, foreign business activities are increasing. Foreign investment is on the rise (USD 1.475 billion in 2010, up 3fl from previous year). One hundred and thirty eight (138) officially registered firms from China (as of 2010), along with several European and South Korean firms, are already engaged in business opportunities in North Korea.¹⁷

Sports Sponsorship in North Korea: Targets, Funding Sources and Experiences

With an annual value of approximately USD 25 billion, the global sports sponsorship industry is an important source of funds for financing sporting activities around the globe.¹⁸ The function of sports sponsorship is understood as “the provision of resources (e.g. money, people, and equipment) by an organization directly

Table 2: Risk Assessment by ONDD, Selected Countries

COUNTRY	<i>Export transactions</i>				<i>Direct investments</i>		
	POLITICAL RISK: SHORT TERM	POLITICAL RISK: MEDIUM/ LONG TERM	POLITICAL RISK: SPECIAL TRANSACTION	COMMERCIAL RISK	WAR RISK	RISK OF EXPROPRIATION AND GOVERNMENT ACTION	TRANSFER RISK
Brazil	2	3	2	C	2	3	3
China	1	2	1	C	3	4	2
Egypt	5	5	5	C	4	5	5
France	1	1	1	B	1	1	1
Germany	1	1	1	A	1	1	1
Japan	1	1	1	A	2	1	1
North Korea	7	7	7	C	6	6	7
Russia	1	3	2	C	3	4	3
South Korea	1	1	1	A	3	1	1
USA	1	1	1	A	1	1	1

Source: Belgium Export Credit Agency (ONDD), December 13, 2012, www.ondd.be.

Note: Political risk: short term/special transactions: Foreign payment defaults of short-term credit derived from foreign currency shortages, wars, revolutions, natural disasters, government actions.

Long-term political risk/transfer risk: Probability of defaults of medium and long-term credits.

Commercial risk: Foreign payment default based on micro-/macro-economic determinants.

War: Risk of external war and internal political violence.

Expropriation risk: Expropriation and breach of contract by the government, plus risk related to the legal system.

Scale: 1-7, 1 = Lowest risk, 7 = Highest risk; A-C, A = Lowest risk, C = Highest risk.

Time of assessment: As of January 2007.

Table 3: OECD Country Risk Classifications on Officially Supported Export Credits 2012

COUNTRY	<i>Classification</i>	
	PREVIOUS	CURRENT PREVAILING
Brazil	3	3
China	2	2
Egypt	5	5
France	0	0
Germany	0	0
Japan	0	0
North Korea	7	7
Russia	3	3
South Korea	0	0
USA	0	0

Source: OECD, www.oecd.org/trade/exportcredits

Note: Composite index: Assessment of credit risk (quantitative) and political risk (qualitative). Specific determinants are confidential and not published.

Scale: 0-7, 0 = Lowest risk, 7 = Highest risk

Time frame of assessment: As of December 31, 2012.

to an event or activity in exchange for a direct association to the event or activity.¹⁹ The motivation for sports sponsorship for private firms can be seen in connection with its marketing and communications strategy. Firms entering into sponsoring contracts pursue several objectives. These include (1) corporate objectives, which are mainly based on the corporate image, (2) marketing objectives, targeting brand promotion, brand recognition and an increase of sales, and (3) media objectives to extend or create brand awareness, to access new markets and to improve the market penetration of existing markets.²⁰

A critical factor in sports is the availability of funds in order to finance new equipment and facilities, the athletes themselves, and travel expenses. It needs to be asked how North Korea can acquire funding for sports when the country is frequently failing to even secure the population's food supply. Despite the lack of access to statistical data and further information on this subject, three sources of funding can be identified: (1) the North Korean government, (2) international sports associations, and (3) foreign private companies.

North Korean Government Funding

Soccer is the most popular sport in North Korea and therefore attracts the interest of the North Korean government, which also provides funding for taekwondo, wrestling and shooting. Several high-ranking party officials are soccer enthusiasts. Due to their privileged position, they are able to act as sports officials and to watch international tournaments. Other factors might also play a role for North Korea in promoting sports, especially its soccer team. Given that soccer requires physical fitness, discipline and tactical skills, Köllner points out that those skills also have a military value.²¹

Funding by International Sports Associations

For the Vancouver Winter Olympics in 2010, the International Olympic Committee (IOC) financed North Korean athletes with USD 115,000 for training purposes under the Olympic scholarship program. The athletes also received financial support for the 2012 London Olympics under the IOC scholarship program.²²

Funding by Foreign Private Companies

North Korea's openness to sponsorship by foreign private firms is paradoxical for an anticapitalist country. This implies that conflicts might arise in working with a profit-maximizing firm. However, North Korea's willingness to open its doors to foreigners is rather astonishing, as the country is known for its sharp restrictions on dealing with the outside world (due to *Juche*), and for trying to minimize international exposure which could jeopardize the stability of its political system. However, in 2005, North Korea initially expressed its strong interest in private sports sponsorship to the international community. The chief executive officer of North Korea's

Sports Marketing Group told international journalists “We [the North Korean sport teams] want to do what all the countries around the world are doing. We want to find sponsors.”²³ The initiative was promoted by the North Korean government and was instantly successful in acquiring the Italian sports apparel company FILA to sponsor the national teams. However, when FILA was sold to a U.S. company, the contract was not renewed. The previously declared target to find at least one big sponsor was still on North Korea’s agenda, but Western potential sponsors were hesitant. One reason for this is that there was virtually no consumer market in North Korea, so that sponsors could not earn profits domestically. Another reason was that sponsoring a team from a dictatorship-led country with bad press on human rights issues could result in international ostracism.²⁴

Chinese firms however, seem to have fewer doubts in supporting North Korea. A decade ago, Erke, owned by the Hong Xing Erke Group, was a relatively unknown sports apparel company. In 2006, the company started sponsoring North Korea’s sports teams and achieved massive brand recognition when the North Korean soccer team qualified for the 2010 World Cup wearing red Erke-emblazoned equipment. The company answered human rights activists’ criticism by saying that their engagement was solely concerned with sports, not politics.²⁵

The latest success of North Korea’s fundraising activities occurred in 2010. When the national soccer team qualified for the World Cup finals for the first time for 44 years, it was able to acquire a four-year USD 4.9 million clothing contract, sponsored by the Italian apparel firm Legea. *Sports Business* reports that Legea outbid Hongxing Sports of China and likely several other European brands.²⁶ Obviously a huge event such as the soccer championship triggered competition to sponsor the North Korean team. But Legea sees a risk that its sponsorship strategy could backfire. A manager of the firm assumes that “it could get to the stage when people stop buying the brand if they’re being seen as propping up a dictatorship.”²⁷

In addition to the apparel firm’s labels being visible to millions of soccer fans, according to FIFA rules, the North Korean team must also speak in public to journalists. This is the kind of circumstance that the political elite tries to avoid whenever possible.

Chinese firms do not hesitate to finance North Korean teams. A manager of Erke has no concerns in working with North Korea, as the country is “an old friend of China.”²⁸ Sponsoring North Korea does not create a negative image for Erke: “Maybe it is different in the West, but we have had no negative feedback from customers in China.... It’s very rare that Chinese customers comment on political matters, so nobody would protest about our sponsorship.”²⁹

However, contrary to common sponsoring contracts, the influence of the sponsors appears to be limited. Erke’s expectations were not met when the Korean team did not wear their sponsored kit on all the occasions Erke would have liked them to. At the widely viewed opening ceremony of the Olympic Games in Beijing, the team did not wear Erke-branded clothes, leaving the sponsor disappointed. According to several commentators, these incidents make it difficult to understand why sponsors still work with North Korean teams: “It’s unclear what motivates them [Erke] to keep

doing business with the team, given the numerous problems they encountered in Beijing, such as the North Korean athletes' refusal to wear Erke's logo at the opening ceremonies since they felt it would distract from the North Korean flag."³⁰

Motivation, Concerns, Benefits

For North Korea

The authorization to enter into sponsorship is difficult for North Korea to achieve in a number of ways and this shows that the country's economic situation must obviously be very severe.³¹ With sports sponsorship, North Korea has established capitalist practices in the country, which includes accepting profit-seeking private firms as business partners. High amounts of desperately needed foreign currency can thus be acquired, representing the strongest motivational factor for North Korean decision makers. This could be interpreted as unethical from an ideological point of view due to breaking the principles of *Juche*.³² The country needs to honor its sponsorship contracts (whether it will do so is a different question), and more importantly its soccer team has to obey FIFA rules, which means the team has to be exposed to international journalists and answer their (perhaps inconvenient) questions. Moreover, the soccer players will also experience life outside of North Korea and may become idols domestically. Some sources even use the term "national heroes" instead of idols. This could instill the general public with a desire to travel to other countries and to support their team when it is playing abroad. Given that even traveling inside North Korea is highly restricted, not being able to travel abroad to support their team could frustrate the people.

The aims of North Korea's participation in international sports events include showing that it is a member of the international community, demonstrating its strength and making the North Korean population believe that the national system's superiority over the capitalist system is stable. Whether propaganda will be able to maintain this effect in the long run remains questionable.

For International Sports Sponsoring Firms

The matter is also a delicate one for sports apparel firms. North Korea appears to be a difficult partner to work with. If a sponsoring firm's products are not presented in the media, there will be no exposure to the general public, which means that target groups cannot be reached. What is the motivation for firms to sponsor North Korean teams? Attracting North Korean consumers may not be possible due to the political circumstances and the lack of wealth in the country. The only feasible rationale is to increase brand recognition by sponsoring a "special" team. However, if consumers connect the brand name with North Korea, this strategy might backfire in many parts of the world. On the other side, based on the sources cited, Chinese consumers appear to be more tolerant.

More Than Just Business

Other effects should not be ignored. Sports sponsorship is an excellent tool for the support of cultural diplomacy. It keeps North Korea engaged with the outside world and prevents the country from completely isolating itself. Athletes can travel to other countries, and are exposed to other ways of life. If they become idols they may enjoy at least a minimum of freedom and international respect in the eyes of the domestic fans. Thus they can become people to identify with.

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Biographical Statement

Sven Horak is an assistant professor at The Peter J. Tobin College of Business, Department of Management, at St. John's University in New York. Before assuming his current position he was a research associate and postdoctoral fellow at the Mercator School of Management and the Institute of East Asian Studies (IN-EAST) at the University of Duisburg–Essen in Germany. He investigates the impact of cultural factors on economic situations.

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