

Teukyakmeip System and Department Stores in Korea

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Abstract

Purpose – This study aims to find ways to create win-win market strategies for department stores, vendors, and customers by studying the operation of the Teukyakmeip system—the distinctive trade system of Korean department stores—and preceding cases.

Research design, data, and methodology – We simultaneously examined various materials, analyzed preceding research, and interviewed department store managers (the parties to the Teukyakmeip transaction).

Results – We examined whether the Teukyakmeip transactions are really beneficial to department stores, but unfavorable to vendors. Significant results emerge including figures and tables.

Conclusions – Department stores will implement and develop the system to advance the win-win partnership by minimizing errors and drawbacks from the system.

Keywords: Teukyakmeip System, Korean Department Stores, Vendors, Vendor Sales Representative.

JEL Classifications: D40, E20, E30, F16.

1. Introduction

Despite a decade long global economic recession, Korea's retail market has experienced and enjoyed a continued growth. According to Youn & Kim (2007), domestic distribution market has witnessed a rapid growth since its establishment in 1996

mainly due to the growth of large distribution companies. However, public demand for fair transaction practices in the distribution market caused the Korean government to enact fair transaction acts to significantly restrict unfair transaction practices by large retailers and franchisers. The enactment of "Large Franchise and Retail Business Act" is a good example of the government policy that ultimately restricted transaction practices of large retailers. The purpose of the Fair Transactions in Large Franchise and Retail Business Act is to facilitate a win-win environment for both the large franchise and retail businesses and their vendors through fair transactions as equal partners (KCCI, 2012). Furthermore, this Act has eventually helped and stabilized not only distribution industry but national economy as well. Some significant unfair transaction issues have been raised by vendors since the enactment of this policy, and public demand through media and politics for fair transactions has significantly increased recently. This study carefully examines and analyzes the distribution industry, especially the large retailers and department stores, and identifies and provides an optimum solution for the department stores, the vendors, and the customers, so that they can coexist in the market through the operation of Teukyakmeip¹⁾ system—a distinctive trade system of Korean department stores (Youn, 2004; Youn et al., 2004; Youn & Kim, 2005; Kim et al., 2013).

2. Economic environment and current state of department stores in Korea and abroad

2.1. Economic condition and market environment at home and abroad

Department stores from all over the world have suffered as the global economy suffered from low growth and recession over the recent years. Japan's department stores are at the brink of bankruptcy while many American department stores

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1) Teukyakmeip (*Teukyak* means special contract, and *meip* purchase) involves department stores buying products from vendors on credit and on sale or return the stores pay the (remaining) price to the vendors after selling the products and deducting certain rates from the (original) price.

continue to reduce the number of stores to manage their financial difficulties (Kim, 2004). According to Korean Department Store Association (2009), domestic department stores are no exception to this global trend. Korean department stores have reached their height and enjoyed their businesses until the discount stores took over the distribution industry in 2003.

2.2. Korean distribution industry and department stores at home and abroad

Domestic distribution industry and Gross Domestic Product (GDP)

<Table 1> Percentage of national economy and employment of domestic distribution industry ("DI")

Category		2009	2010	2011
Gross domestic product ("GDP") (%)		7.2	7.4	7.5
Employment (%)		15.3	15.0	15.0
GDP (unit: billion won)	Total	981,625.1	1,043,666.3	1,081,593.9
	DI	70,861.5	76,864.4	81,586.2
Number of employed (unit: thousand persons)	Total	23,506	23,829	24,244
	DI	3,600	3,580	3,638

Source: Korea Chamber of Commerce & Industry(2012).

Korean department stores have experienced rapid growth along with the growth of national economy since Kyeongsung branch of Japan's Mitsukoshi department store—the former of the current Shinsegae Department Store—opened in 1930 in Korea (KDSA, 2009).

<Table 2> Sales and growth of distribution industry

Category	Sales figures (trillion won)			Growth rate (%)		
	2011	2012	2013 (F)	2011	2012	2013 (F)
Department stores	27.1	28.4	29.8	11.4	4.9	4.9
Big box retailers	36.8	37.3	38.3	9.0	1.4	2.7
Supermarkets	25.4	26.4	27.2	6.5	4.1	3.0

Source: Shinsegae Distribution Industry Research Center (2013)

2.3. Understanding of the Teukyakmeip system: both home and abroad

2.3.1. Teukyakmeip system under the Large FRB Act

Fair Trade team of BKL(2012) suggested that legal understanding of the Large FRB Act should always come before figuring out the origin of the Teukyakmeip system and the form of transaction. KCCI(2012) also indicated that the purpose of the Fair Transactions in Large Franchise and Retail Business Act

was to promote balanced growth and development of the national economy by establishing fair transactions among large franchise, retail business, and vendors and enabling large distribution companies and vendors or sales floor tenants to maximize equal and fair opportunities while complementing each other. The Act is based on Article 119-2 of the Constitution of the Republic of Korea, which states the following: "The State may regulate and coordinate economic affairs in order to maintain the balanced growth and stability of the national economy, to ensure proper distribution of income, to prevent the domination of the market and the abuse of economic power and to democratize the economy through harmony among the economic agents."

Under the legal definition of the Teukyakmeip transaction per Article 2-5 of the Large FRB Act, the term "Teukyakmeip" or "purchase under a special contract" means a transaction in which a large distribution company purchases goods on credit from a vendor under the condition the company is allowed to return all those unsold goods to vendors and pays a total sales amount after subtracting a specific margin from the total sales.

2.3.2. Forms of transaction by domestic and foreign department stores

Table 3 depicts different forms of transaction that are often used by both domestic and foreign department stores. All these transactions are somewhat similar but each has specific contents that separate them from the rest.

<Table 3> Classification by form of transaction of domestic department stores

Category		Contents
Direct management	Subcontract	Department stores purchase the goods from vendors. Goods are generally produced under department stores' own trademark and in accordance with the distinct specifications of department stores, e.g., shopping bags and some apparel items.
	Direct buying	Department stores, under their responsibility, purchase the goods of makers, so they have full and independent responsibility of management and inventory of goods, e.g., food and clothing.
	Teukyakmeip	Similar to direct buying, under this form, department stores only pay vendors the goods they sold and return unsold goods to vendors, e.g., food, sundries, apparel, home supplies, etc.
Lease	Lease B or Eul	The direct management by a vendor in order to continuously maintain the inherent brand of the vendor, so-called "sales floor required for commission". This form applies to special food courts, shoes, and men's apparel. Some require a security deposit and pay a certain rate from the sales instead of a monthly rental rate.
	Lease A or Gap	This form is used for the transaction of accommodating public interest businesses, e.g., banks, post offices, pharmacies, flower

	shops, and seen as the typical lease transaction. Security deposit and monthly rent are specified and required.
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Source: Korea Department Store Association (2012).

Under the Teukyakmeip system, vendors directly plan, choose, and sell goods as the direct buying system, and department stores mainly focus on developing the strategies for store management, marketing mix, and store branding.

<Table 4> Teukyakmeip and direct buying

Category	Teukyakmeip	Direct buying
Plan & selection of goods to be displayed	Done by vendors	Done by department stores
Ownership of the goods	Owned by department stores after warehousing of goods	
Inventories	Unsold goods are returnable.	A charge on department stores
Sales activities of goods	By vendors	By department stores
Brand strategy	Jointly executed by department stores and vendors	

Source: Korea Department Store Association (2012).

2.3.3. Direct buying system to consignment (or consignment buying) system

DAIMARU, converting the department store without 'direct buying', had to reform its business practices several times, and they first decided that they would not apply the direct buying system to most of their shops. The concept of the "retail business without direct buying" originated from this particular incident. Until the 2nd reform of the business, DAIMARU had also attempted an in-depth merchandising. But upon analysis of the results of such reform, they came to the conclusion that the core competency of the department stores was not a type of a merchandising. They tried to focus on "appraisal and mix of a vendor" which was found as the new core business competency. The general purchase method up to this time was the direct buying system, where the department store would appraise goods and then place an order of the goods. Department stores eventually allowed vendors to provide goods, and they chose among those goods, i. e., promoting direct competition among vendors and acquiring a variety of goods. Retail business without direct buying means one which changes from direct buying to indirect buying, namely 'appraisal and mix' (Tsuyoshi, 2010).

2.4. Current state of Teukyakmeip system

In order to evaluate the actual condition of the Teukyakmeip system operated by domestic department stores, this paper examined current situations of vendors who maintain business relations with the top three Korean department stores

and the claims from media that department stores are unfairly establishing profit margins by line of goods and exercising their power to the Teukyakmeip Vendors.

<Table 5> Transactions of department stores' vendors (2012)²⁾

Company	Form of transaction	No. of vendors	Percentage (%)
Lotte Shopping	Direct management or buying	18	1.3
	Teukyakmeip	988	68.1
	Lease	443	30.6
Shinsegae Department Store	Direct management or buying	150	10
	Teukyakmeip	1, 099	71
	Lease	298	19
Hyundai Department Store	Direct management or buying	51	2.7
	Teukyakmeip	1, 424	75.3
	Lease	416	22.0

Source: Data provided by top three (3) department stores in domestic sales figures

<Table 6> Top and bottom five items in sales margin

Top five items			Bottom five items		
Ranking	Items	Margin (%)	Ranking	Items	Margin (%)
1	Shirt & necktie	35.89	1	Book, musical disk & instrument	10.54
2	Women's casuals	32.89	2	Major domestic appliances	13.74
3	Women's suit	32.76	3	Small domestic appliances	20.16
4	Baby & child	32.63	4	Foreign luxury brands.	21.14
5	Men's casuals	32.50	5	Fresh food	21.66

Source: Fair Trade Commission (2012).

3. Analysis of the in-depth survey of the Teukyakmeip system

3.1. Designing survey of the Teukyakmeip system

3.1.1. Survey design and analytical method

Category	Contents
Sample	■ Vendors currently have the Teukyakmeip transaction with three main department stores in Korea ("Teukyakmeip Vendors")

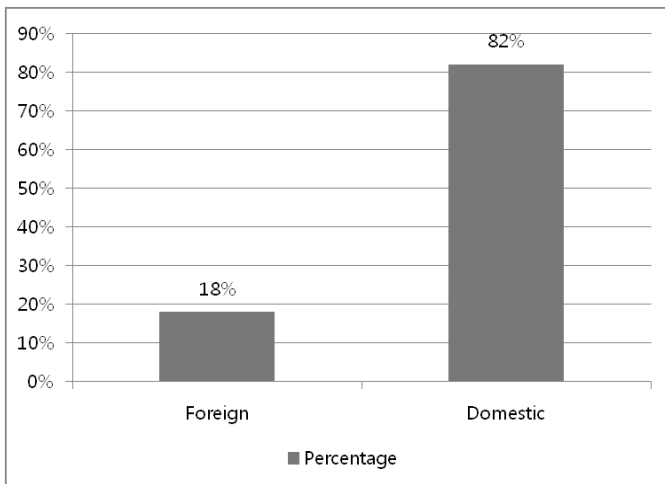
2) Regarding the question of "How many Teukyakmeip Vendors does your department store have?" in the above Table 5, department stores stated, respectively, the following: Lotte 68.1%, Shinsegae 71%, and Hyundai 75.3%. While Lotte has the lowest percentage, about 68% in its reply, it has the highest percentage, 30.6%, when asking the lease form.

Survey method	■ Survey questionnaires are randomly distributed through mail
Valid samples	■ A total of 72 responses (from the Teukyakmeip Vendors of Lotte, Shinsegae, and Hyundai) were appropriate to use, a response rate of 80%.
Way of selecting samples	■ Random sampling
Industrial classification	■ Clothing 56% (40 samples), and sundries 44% (32 samples including clothing)
Survey period	■ March 23 to April 30, 2013

3.2. Findings of the survey

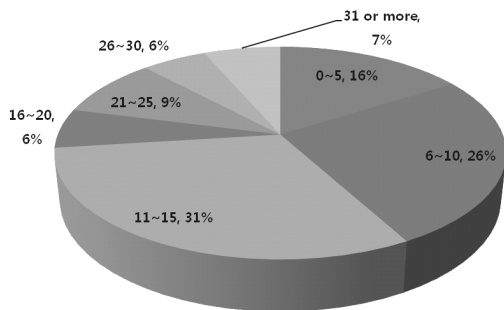
3.2.1. Outline of the Teukyakmeip Vendors

3.2.1.1. Teukyakmeip Vendors' nationalities (domestic and foreign)



<Figure 1> Domestic and foreign Teukyakmeip Vendors

3.2.1.2. Transaction period

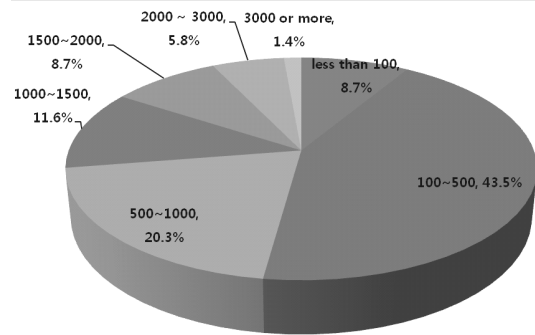


<Figure 2> Transaction period of the Teukyakmeip Vendors (unit: years)

As shown in Figure 2, the transaction period between department stores and Teukyakmeip vendors are generally long, only sixteen percent and below had a five-year or less transaction period. This data suggests that the Teukyakmeip transaction seems to be attractive: 58% of the participants indicate that

they maintain eleven or more years of business relationship with the department stores.

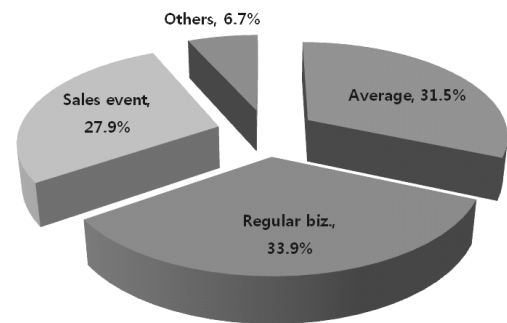
3.2.1.3. Annual sales



<Figure 3> Annual sales of the Teukyakmeip Vendors (unit: 100 million won)

The majority of the Teukyakmeip vendors, 43.5% of the participants, are in the range of 100 to 500 million won; 20.3% stated they earned 500 to 1000 million won, 11.6% 1000 to 1500 million won, 8.7% under 100 million won, 5.8% 2000 to 3000 million won, 1.4% 3000 or more million won.

3.2.1.4. Profit margin



<Figure 4> Profit margin of the Teukyakmeip Vendors (%)

33.9% profit margin was realized from regular business and 27.9% from sales event.

3.2.1.5. Dispatched detailers

<Table 7> Views of sending detailers³⁾ to department stores (unit: %)

Items	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree
(1) Sales activities will be done smoothly without detailers.	1.4	5.6	1.4	45.8	45.8

3) Detailers hereof are not the employees of department stores, but the persons from vendors or makers to promote sales and/or to support the store.

(2)	If a detailer is removed from your store and the employees of a department store take charge of sales activities at your store, your sales will be reduced greatly.	47.2	48.6	4.2	0	0
(3)	Dispatching detailers is more beneficial to vendors than a department store in the form of the Teukyakmeip transaction.	18.3	52.1	23.9	4.2	1.4
(4)	The system of dispatching detailers is beneficial only to a department store.	0	1.4	27.7	41.7	29.2
(5)	Dispatching detailers can lead to increase in sales rather than rise of labor costs.	33.8	52.1	12.7	1.4	0

3.2.2. Lessons learned from the results of the survey

Almost 96% of the respondents agreed with the statement that the most basic reason why the Teukyakmeip Vendors have strong business relations with department stores is because the public image of their goods will increase with the image of the high-profile department stores. The working conditions and management of detailers have recently become one of the controversial issues in the Teukyakmeip system, but all of the participants denied this as a controversial issue. To the question of "How reasonable is the profit margin?", 41% indicated positive and only 17% responded with negative. No matter how reasonable the profit margin is set in Teukyakmeip transaction, the lesser the profit margin is, the better the Teukyakmeip Vendors are because of the nature of its transaction. Some issues related with the profit margin between department stores and the Teukyakmeip Vendors need to be resolved based on 17% negative response rate; however, the majority of vendors, 41%, are satisfied with their profit margin.

Seventy-seven point 8 percent (77.8%) of the survey respondents suggested, "The Teukyakmeip system accommodates the situations of vendors." Seventy-five percent (75%) of the participants agreed, "The system is beneficial to both the department store and the Teukyakmeip Vendors". In the same concept, 70.6% of the responses disagreed with the following question, "Is this system advantageous only to the department store?" Almost 96% responded that their sale would decrease and responded negatively to "If a detailer is removed from the store, how do you expect a change in sales, compared to the one at the present?" As to the reasonableness of interior design cost paid by the Teukyakmeip Vendors when entering the transaction, 62.5% stated that it is reasonable and that they believe the cost to be their initial investment. A large percentage, 91.4%, agreed that "The cost for entering a department store is similar to or less than directly opening a road shop." Considering that "Entering major department stores" has positive influences on brand awareness and credibility of small and medium businesses ("SMBs") or new brand, it is found that the Teukyakmeip Vendors can develop their brand power by bearing "relatively inexpensive cost of interior design". However, the

opinion from the Teukyakmeip Vendors to the warranty period of replacing interior design is "2 years" and this answer accounted for 64.8%; therefore, further discussion for reasonable warranty period would resolve this issue. Based on this analysis, the argument of department stores' advantages over the vendors under the current Teukyakmeip system was inaccurate and should be treated as a biased opinion. The major transaction form in America is direct buying, and while Japan has also tried to introduce and operate direct buying transaction form for a while, it has failed. Currently, it is changing their transaction system to Teukyakmeip system or digestion purchase system/consignment (purchase) system. Although any transaction system of goods has its own merits as well as its deficiencies, the Teukyakmeip system is fairly useful and applicable in Korea considering the market environment of department stores and their characteristics in Korea. Overwhelming positive response of and attitude towards the Teukyakmeip system by the vendors demonstrate that maintaining the Teukyakmeip system in Korea is critical and beneficial to both parties.

4. Proper function and economic effect of the Teukyakmeip system

4.1. Merits and economical effects of the Teukyakmeip system

<Table 8> Realistic interpretation and stance of the Teukyakmeip system

Category	Appropriateness of the Teukyakmeip system	Different views
Department stores	<ul style="list-style-type: none"> Introducing direct buying system is actually difficult under the current business infrastructure: 70% failed and 10% succeeded in Japan. The Teukyakmeip system would promote supporting effects of improving management to ease the investment of the vendors 	<ul style="list-style-type: none"> Lack of understanding on initial huge investment by department stores (real estate, decoration cost, etc.) Complexity in transaction to sort out increase in selling & administrative expenses and the profits & losses by department stores The intangible benefits that vendors receive are not recognized.
Vendors	<ul style="list-style-type: none"> The alternative of opening road shops is much more expensive than the initial investment of entering department stores. Through entering, vendors not having brand power can attract customers. Stably managing the operation with the trust and credibility of department stores 	<ul style="list-style-type: none"> The hostile view of a huge profit that department stores earn from economy of scale Regarded the system as a general leasing agreement of real estate Vendors would feel the profit-sharing is unfair

<Table 9> Benefits of the Teukyakmeip system to vendors

Good impacts	Contents
Right to adjust the price of goods	Vendors can decide the price of the goods under their brand name depending on the market situations.
Right to adjust the quantity of goods	The goods can be easily and unrestrictedly managed by vendors, and the quantity of the goods can be adjusted according to vendors' needs.
Authority over detailers	Vendors are fully responsible for and in control of their detailers and contribute to increasing sales through this system.

<Table 10> Economic effects of the Teukyakmeip system

Category	Economic benefits
Distribution Industry (Department stores)	<ul style="list-style-type: none"> ● Reduce risk in management of goods (in stock), specialty and fashionable character. ● Cost incurred on direct buying can be used for management of stores (encouraging efficiency). ● Cooperation could lead to expansion of business at home and abroad. ● Maintaining and improving competitiveness at home and foreign retail market.
Small businesses (vendors)	<ul style="list-style-type: none"> ● By easing the burden of high initial investment of SMBs who are vulnerable to limited capital, they can stabilize their business and management of their business operations. ● Easy to enter in the market and compete with famous brands. ● Create jobs by hiring and dispatching detailers and learn the advanced management techniques from department stores. ● Easy to access and obtain the information about consumers and their behaviors and apply them to improve their goods.
Consumer (service, welfare)	<ul style="list-style-type: none"> ● Enjoy high-quality customer service provided by department stores. ● Enjoy various benefits of promotion by department stores and their vendors. ● Do pleasant shopping at the high-class facilities of department stores. ● Pursue their happiness through the suggestion program for goods and service.

5. Conclusions

5.1. Desirable operating scheme of the Teukyakmeip system

5.1.1. Reason why it is difficult for department stores to increase direct buying in reality

Considering the variety of goods and brands at department stores, the direct buying system is not appropriate in maintaining fashion, strong points of merchandise sales, and direct management. When direct buying system applies to department stores, it would compromise individual customer service and could become a self service that many big box retailers or supermarkets prefer to have. In general, fashionable goods and

brands play a leading role for sales in department stores, and fashion industry is supersensitive to styles of clothing and appearance. Therefore, a professional and knowledgeable salesperson is essential to selling/dealing with the fashion brands, but it is difficult to dispatch such professional detailers to department stores under direct buying system. Department stores as a whole could have difficulty in understanding consumer needs and spending pattern, and this can lead to loss of opportunities to sell the goods that consumers want to buy. Vendors don't have complete inventory control system, so they can't manage goods efficiently which could lead to poor inventory management.

5.1.2. Objections to the negative effects of the Teukyakmeip transaction

<Table 11> Objections to the negative effects of the Teukyakmeip transaction

Negative effects	Objections
<ul style="list-style-type: none"> ● Leaning too heavily on famous brands and department stores and becoming polarized hinder balanced development. ● Enhancement of department store businesses is impeded by insufficient competency in merchandising. ● Passing along high expenses to middle and low brands curtail the ability of SMBs to invest and compete. ● Existing occupants create the barrier to entry for new & promising SMBs, and this makes it difficult for them to find a market. ● A new department store to acquire famous brands is too difficult. ● Too much investment in downstream marketing becomes negligent in upstream marketing and R&D division. 	<ul style="list-style-type: none"> ● A balanced development could be a problem, but this system provides the opportunity to increase the competitiveness and foster small but strong SMBs. ● Function of merchandising can't become the practice of advancement of a department store. Operating techniques and customer service should be such a standard. ● Entering department stores can be understood as the opportunity to expand the market for SMBs. ● Vendors have the right to freely enter or leave at the time of renewal, and reorganization of merchandising is based on the appraisal of the efficiency of sales figures. ● Under the circumstances of the domestic retail market, the entry of a new department store is difficult. Samsung plaza in Bundang was sold to AK. ● Investment by department stores to marketing as a whole is beneficial to both the department stores and the vendors, and the cost passes along to consumers in reality.

5.1.3. Objection to the argument that the Teukyakmeip system is past its sell-by date

According to KDSA(1995), the Japanese vendor, 'Onward Kashiyaama', introduced the consignment system to make it easier to enter department stores. When the department store in Japan, DAIMARU reformed its business to build a new model, it created the new concept of the 'retail business without direct buying' and applied this concept to 80% of their stores. The

history of department stores in Japan is longer than that of Korea, and Korea, having followed mainly its business model, a further and detailed study as to the reason why it has expanded again to the consignment system is necessary (Kim, 2010).

5.1.4. Independent merchandising by department stores doesn't mean direct buying

Independent merchandising by department stores is really aimed at (a) embodying originality when stores or vendors are assorting goods and (b) providing customers with goods at a reasonable price. This means that department stores themselves should develop a marketing strategy, but they also have to understand the needs of the customers and decide the concept of how merchandise of various types and prices are established. Independent merchandising is usually considered as the merchandise independently developed by department stores or direct buying, but it means the original and distinctive merchandising or commercialization by distribution companies in a broad sense.

5.2. Final conclusions and suggestions

5.2.1. Relation of Teukyakmeip and direct buying

1. Current form of transaction \rightleftharpoons Teukyakmeip > direct buying = contribute to the mutual co-existence – maintaining continuously the benefits on the current transaction.
2. Adjusting the form of transaction \rightleftharpoons Teukyakmeip < direct buying = harm to the mutual co-existence – become disadvantage to vendors which are insufficiently competitive and manageable.

5.2.2. Final conclusions and implications

Future research on department stores with the supplier and customer relationships will be useful to verify the findings of this study. The findings of this study indicate that Teukyakmeip system is a culturally adequate system for Korean department stores and their vendors as the rider-rider system of Japan, and America is appropriate for their business culture. The most basic reason as to why the Teukyakmeip Vendors have strong business relations with department stores is that the public image of their goods will increase with the image of the high-profile department store, and almost 96% respondents agreed with this statement. A large number, 77.8%, of the survey respondents indicated that "The Teukyakmeip system accommodates the situations of vendors," and 75% of the participants agreed, "The system is beneficial to both a department store and the Teukyakmeip Vendors". These findings contradict the negative public views of the Teukyakmeip system, and it shows the Teukyakmeip system is beneficial to small and medium vendors.

Regarding the argument of having department stores change their current transaction system to direct buying system, both failed examples of Japan and America clearly show that this ar-

gument is flawed. Upon examining the relation of the Teukyakmeip and direct buying, the mutual co-existence can be maintained through the current Teukyakmeip system. With the direct buying system, there would be no mutual relationship, and vendors can be faced with fierce competitions among them. Therefore, placing greater efforts to improve the current Teukyakmeip system would benefit all stake holders (Kim, 2013).

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