The Dynamics of Small and Medium-Sized Enterprises in Korea and other Asian NIEs

*Philippe Regnier**

ABSTRACT. After a brief comparison of data on small and medium-sized enterprises in the four Asian newly industrialized economies (Hong Kong, Korea, Singapore, Taiwan), this paper deals with the existing or potential role of small firms in Korea's industrialization process; it reviews Korea's industrial heritage up to the post-Korean war period, then concentrates on the last three decades of very rapid industrial development and on the numerous issues facing the Korean economy today, especially in the field of big versus small-medium scale business. This particular issue is again at the centre of policy changes, debates and controversies since the beginning of the 1990's.

The major arguments of this paper can be summarized as follows: Very little is yet known about the history of Korean small entrepreneurship before World War II and how it might have affected later industrialization process after the Korean war. It seems that little indigenous industrial expertise was accumulated before and during colonial rule, this last period being dominated by the Japanese in a few big key industries, the very start of big scale business in Korea.

The period 1953—61 was marked by the emergence of Korean large firms related to big privileged families and decision makers. Many market distortions were introduced in their favour, but there was also an obvious development of small business in the absence of any defined state policy in this field.

After the "military revolution" of 1960—61, the important role of small and medium-sized enterprises was already recognized by the government in 1962, although only on paper. The strategy of export-led industrialization received priority and the concentration and expansion of existing or new large firms were supported by government funding. Small private entrepreneurship was directly or indirectly discriminated till the mid-1970s; But after a relative decline during this period, it showed a strong and renewed capacity of survival and development since the late 70s/early 80s. This was probably the result of induced rapid growth from the global economy with increasing needs of production diversification and flexibility, especially through various types of subcontracting.

Since the mid-80s, Korean business and government circles have become more acutely aware of the necessity to promote small business in order to cope with some of the major economic and social restructuring issues facing the country. Most government agencies supposed to promote small business have not been well prepared to grasp at the real expectations and needs of small entrepreneurs.

After Japan and Taiwan, Korea is a new candidate for a rapid internationalization of her most promising small firms, and the next ten years should bring up many business matching opportunities between Korean small firms and foreign partners, not only in marketing and trade but also in finance and technology.

1. Small business in South Korea: definition and regional comparisons

The development of small and medium-sized enterprises in the four Asian NIEs has followed either somehow the "Japanese model", with very compact industrial branches dominated by big conglomerates and vertical integration between them and small firms (like in Korea), or the "Hong Kong model", with the small firms reacting freely and independently to diversified domestic and

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international orders. The examples of Taiwan, where the role of small enterprises is impressive, and of Singapore, where it is still very modest, are between these two "models". This illustrates the well cut similarities and differences between the four Asian NIEs. Statistical data shows the relative or important contribution of small firms to the overall economic performance of the four economies. There are 1 060 million small firms in Korea, 730 000 in Taiwan, 90 000 in Hong Kong and 70 000 in Singapore, in both industry and services. The definition of small business differs in each case, but small enterprises represent on average 91 to 98% of total existing companies, 46 to 70% (Taiwan) of total workforce, 31 to 57% (Hong Kong, Taiwan) of total value added, and 17 to 66% (Taiwan) of total exports. The first two indicators show little difference between the four economies: only Singapore ranks behind because of the dominating role of multinational corporations and big public holdings in the economy of the small island republic. According to the third indicator, Hong Kong and Taiwan come first because of the key role of their small firms. Then, Korean and especially Taiwanese small and medium enterprises are extremely dynamic in terms of their contribution to total exports, even if there is a sharp gap in favour of Taiwan. Based on a strong tradition of Chinese entrepreneurship, small and medium-scale firms are today an essential pillar of the regional and world globalization of the Taiwanese and Hong Kong economies (See Table 1).

Small business in Korea is defined by the Small and Medium Industry Basic Act of 1966. Small enterprises are defined as those with up to 20 employees (up to 5 in services) and they represent 57% of all existing firms in manufacturing, 10% of total employment, and 4.6% of total value added. Medium-sized enterprises are those with 21–300 employees (up to 200 in construction, up to 20 in services). Exceptions are made for some labor-intensive subsectors, for which the maximum size of a medium-sized enterprise can be expanded to 1 000 employees, and for some capital-intensive industries, for which a company with the requisite number of employees may be excluded if its capital assets are considered too high.

Cooperatives organized under the Small and Medium Industry Cooperative Act of 1961 and mainly affiliated to the Korea Federation of Small Business (founded in 1962) are also regarded as small and medium-sized enterprises. Any firm once defined as a small or medium-sized firm but which grows beyond the limits of these government definitions — either through expansion or merger — continues to be regarded as such for the three years following the change of size. The qualifications needed from a small firm to apply for assistance from the Small and Medium Industry Promotion Corporation (SMIPC, the major state agency dealing with Small and Medium-sized

TABLE I

The role of Small aned Medium-size Firms in the four Asian Newly Industrialized Economies

Small Firms total in	in % of total number of companies	in % of total work force	in % of total value added	in % of exports
Hong Kong	98	62	57	17
Singapore	91	46	31	18
South Korea	98	66	38	34
Taiwan	97	70	55	66

Source: Government Statistics, 1987–88.
Small Firms defined according to local sources.

- Hong Kong: 1 to 200 employees
- Singapore: corporate assets below S$ 8 millions
- S. Korea: 1 to 300 employees
- Taiwan: declared capital below NT$ 40 millions and corporate assets below NT$ 120 millions

1US$ = 1.68 S$ = 26.15 NT$ (October 1991) firms) are that the firm employs a constant workforce of over five persons, that its total assets are over 100 million won, that it has been in operation for over a year at the time of application, and that is specializes in a priority subsector (among those defined every year by the Ministry of Trade and Industry) which amounts to 50% of its total population.

2. Korean entrepreneurship and small business till World War II

The entrepreneurship character and pre-industrial heritage of a nation are determinant factors to be considered in analysing the nature and the engine drive of its economic take off and later development. This fact was demonstrated once again, taking the case of Hong Kong as an example, in Wong Siu-Lun's recent book on the role of the dynamic emigrant industrialists of Shanghai before and after 1949 (Wong, 1988). But in the case of Korea, a very satisfactory economic history, especially dealing with the identity and role of the country's entrepreneurs, has yet to be produced. As mentioned by several authors like Michell or Kim and Roemer, research in progress on both the colonial and post-liberation periods has challenged many of the existing notions of Korean development in the first half of the 20th century (Kim and Roemer, 1981; and Michell, 1988). There is no authoritative analysis of the degree to which the Korean pre-1945 heritage has been transmitted to the present and how it influenced development between 1945 and today. It is quite hazardous to asset how the too partial and incomplete economic data available for the pre-war period could shape a valid explanation of the post-Korean war rapid industrialization and the role of small entrepreneurship in particular.

However, a few general views of the shape of the Korean industry before 1940–45 can stimulate a better understanding of local entrepreneurship till today and also incite to further historical research if needed.

It seems that several signs of early capitalism can be observed in Korea during the 18th and 19th centuries, though less clearly than in neighbouring Japan or China. Local enterprises in the modern sense were created by noble landlords and merchants, especially in trading, but didn't recruit much from the handicraft sector or the peasantry. Then, very little industrial capital and expertise were accumulated in manufacturing before Japanese colonial rule: even prior to Japanese colonization, business in Korea seems to have been foreign dominated (Hamilton, 1986). (See Table 2).

TABLE II
Small and Medium-sized Firms by Industry in Korea, 1987 (in %)

	No of establishments	No of workers	Value added
Manufacturing and Mining	97.7	57.4	39.1
Transportation	97.7	68.4	58.4
Construction	94.9	29.2	25.7
Wholesales & Retail Trade	99.4	89.7	—
Restaurants & Hotels	99.6	92.3	—
ALL SECTORS			
– SMEs	99.3	66.8	39
– Large Firms	0.7	33.2	61

Source: Small and Medium Industry Corporation, Major Statistics 1988.

The vast majority of traditional entrepreneurs didn't make a very significant contribution to a spontaneous industrial start, and this might partly explain why the germs of the future big scale industrial facilities had to be initiated from other local and foreign sources during and mainly after the colonial period and the Korean war (Park, 1989; and Ouh, 1988).

During the colonial period and mainly between 1910 and 1940, a period for which some Japanese statistics are available (only commodity-product statistics but no consistent production index or national income data), some small enterprises did however emerge, but were dominated by large-scale manufacturing enterprises (essentially controlled by the Japanese). The colonial power did restrict the development of indigenous capital, though competing against the zaibatsu would have been impossible even without restrictions, as noted by Fields (Fields, 1990). Around 1938–40, the Japanese controlled about 89% of all existing company business if classified by paid up capital, but only 58% of the number of establishments, that is to say essentially large firms, the rest being made of Korean small firms with a paid-up capital less than one-fifth of the average compared to their Japanese counterparts. Most of Japanese investment was in large and military related industries like chemicals, metal industry, textiles and processed food, and there was more and more emphasis on heavy industry in the late 1930s (55% of all manufacturing activity in 1938) because of Japan's military expansion in neighbour China. In 1940, the Japanese over-dominated all modern manufacturing sectors, except machinery and printing (58% and 57% of total business only for each sector); there were only 14 agricultural and 10 industrial Korean-owned companies with capital exceeding 500 000 yen, and only 3 of the later 20 largest chaebols (Samsung, Daelim, Kia) started before the end of Japanese rule (Lee, 1989; and McNamara, 1988).[1] On the whole, the Koreans remained predominantly engaged in traditional activities, with less than 20% of all technicians and highly skilled labour being Korean in the manufacturing industry. However, Hamilton (1986) argues that several thousand Korean businessman had emerged and that they would form an important component of the new commercial and industrial capitalists in the 1950s. Globally until 1940, there were tangible signs of rapid industrialization in Korea: manufacturing is believed to have grown from 3% (in 1910–12) to around 20% of total commodity produce, and Korean manufacturing labour grew from 12 000 to over 300 000 (with 28 000 Korean skilled workers and 7 000 engineers and technicians), but these developments did not have too much of an impact on the existing Korean small firms (Suh, 1978).

3. Small entrepreneurship in Korea till 1960–61

The post-war period till the military "revolution" of 1960–61, although very much shaken by major troubling events like decolonization, partition and the Korean war, is characterized first by the emergence of Korean large firms, directly or indirectly supported by various governmental economic and political measures, possibly introducing some initial market distortions in favour of this type of firms. However a spontaneous development of Korean small business also takes place, in the absence of any defined state policy except a few conjonctural measures of support decided after 1952–53.

3.1 *Large firms*

During the early years of the Republic of Korea, the former Japanese large scale industrial facilities (especially the so called three "white" industries: textiles, cereals and flour, sugar) were sold at concessionary prices to a limited number of Korean privileged families and entrepreneurs close to the Korean liberal party and to US aid. This marked the right beginning of Korean modern enterprises and entrepreneurs and the creation of a true industrial basis serving the domestic market first and not export-oriented (basic import substitution). Supported by various privileges and protective administrative measures (Park, 1989, pp. 777–79), and also by US material and financial preferential assistance, big firms grew rapidly in the field of equipment and very basic consumer goods, and dominated in several branches (as it was already the case for their Japanese ancestors before 1940). 13 of the 20 industrial chaebols existing today appeared during the Rhee's regime, even if their real growth period comes after 1960–65 under President Park (Amsden, 1989; Jung, 1988; and Kim, 1976).

3.2 *Small firms*

During the same period, the protection of the domestic market and the business concentration in just a few industrial sectors have left some room for further spontaneous development of small businesses, producing and marketing with minimum capital and technological know how a range of basic consumer goods. This was also made possible in an overall context of very poor infrastructure and services, especially after the devastating Korean war, and of a limited government capacity to act on all economic and social fronts (Ho, 1980). No doubt that vast imputs of military, technological and financial US assistance shaped new entrepreneurial initiatives and know how.

In order to promote the local supply of daily consumer goods, the government did some short term and urgent financial support to those small firms facing difficulties. In 1952, an initial fund was launched for priority industries, and in 1953, the United Nations Korean Reconstruction Agency created a special fund. Various complementary measures dealing with small business financing were adopted in 1953–59. A first small business promotion report was published in 1956 and it suggested some type of cooperative federation of small firms, more adapted financial aid, marketing facilities, fiscal exemptions and fair taxation. This was certainly the very first time that a specific reflection on the future of local small business, distinct of the global thought feeding the future prospects of large scale industrialization process, was produced. It will be re-utilized and enlarged after 1961 for enacting the first pieces of national legislation dealing with small business promotion. But, for the entire period 1948–61, governmental action remained limited in practise to very conjonctural financial support to some of the accessible small firms, without any significant application of the more elaborated ideas put on paper, especially in the late years of the Rhee regime. (See Table 3).

TABLE III
Concentration of Korean Industry in 1958

Industries	Number of Companies Total	Big Firms	Total Value Added Big Firms (% of total V.A.)
manufacturing (all sectors)	12 971	115	33
– agro-food	1 473	8	24
– textiles	2 801	44	55
(coton)	(701)	(15)	(84)
– plastics	120	15	70
– cement	3	2	99

Source: KIM B. T. et al., *The Development Process of the Korean Economy*, Seoul (1981, p. 144) (in Korean) (quoted by Park (1989, 179))

4. Big versus small scale industrial environment in Korea after 1962

How is it possible to promote or even keep alive small entrepreneurship in a context of an export-led growth strategy essentially based on the expansion of large industries, a big public sector, strong and authoritarian state intervention, and massive foreign borrowings and investments? With the First Five Year Plan of 1962 already, the new Korean regime did recognize on paper the important role of small business in balance with big firms (but it exclusively privileged, contrary to the Taiwanese policy, mammoth industrial strength through the promotion of big conglomerates and through all kinds of economies of scale similar to those of the early phases of industrialization in Japan). Even after the apportive measures adopted in 1961–62 against some of the local big fortunes (which were judged by the new regime as illegally accumulated during the 1950s, but also rapidly replaced by the fortunes of the new business-military elite in power), there were just a few hundred big companies which produced (in the period 1963–65) about half of the total industrial output and more than two thirds of total exports. Much as been written already about big industry and the dominating power of the chaebols in Korea till the early 1980s, but much less is known in details, including in Korean language, about the various distortive impacts on small entrepreneurship during this period.

In his recent extensive research on the subject, Park (1989, pp. 183–188) makes some interesting guideline suggestions: selective export promotion measures in favour of big firms (to be internationally competitive by all means) would have not benefited small firms which were structurally domestic market oriented and not prepared for exports; import tariff exemptions would have been granted to those big scale exporting firms needing raw materials and equipment at low price, but high protection for implementing progressive import substitution would have been the general rule; most small firms would then have to cope with high import prices for all kinds of products and equipment not available locally and would be condemned to stagnation in traditional activities or to slow growth in more modern ones; initial scarcity of local capital and massive state borrowings overseas would have privileged priority loans to big business and leave small enterprises alone to cope with high domestic banking rates and insufficient collateral and garanties to offer; foreign direct investment and state selected joint-ventures would have favoured medium-sized and especially big firms, 76% of all foreign investments going in firms of 300 employees (28%) and over for the period of 1968—78 (Kim, 1983); priority employment and social policy in favour of big industry would have been detrimental to small firms, which had greater difficulties in offering their employees good working conditions and enough social consideration.

4.1 *Korean small firms and the first two five year plan (1962—72)*

With the adoption of the Small and Medium Industry Basic Act (1966), the government embarked on a very selective policy of support to the most promising small firms. These include those enterprises able either to promote Korean exports, or to effectively subcontract components and parts to manufacturing big firms, or to have the capacity to become within a few years medium and big scale companies because of strong competitive habilities of their own or because of close collaborations with government industrial programs. In practise, 13 priority sectors for manufacturing exports were selected by the government (and this type of periodical selection has remained till today) but only 1 315 existing small and medium firms received some export oriented promotional treatment between 1964 and 1972 (Small and Medium Industry Bank, 1989). In addition, five export oriented industrial parks, opened to selected small firms in particular, were created.

4.2 *Korean small firms and government policy in 1972—79*

During the period of rapid expansion of the heavy industry/chemical/automotive/electronic chaebols, the potential dynamics of small private entrepreneurship was considerably neglected. Over state intervention in most economic and social areas produced some numerous regulations on small firms, which were not meant in their real favour but to benefit mainly big firms and economies of scale. These measures, quite extravagant and often unapplicable in practise, ranged from the definition of sectors and sub-sectors of manufacturing exclusively reserved to small businesses to the protection of small firms against big business unfair practises or against too much competition among small companies (Small Business Co-ordination Act, 1978), It also included the controlled specialization of some small firms as subcontractors to the big industry (especially for components and parts), and the development of rural parks for small and medium enterprises. Compared to the number of administrative decisions taken and the number of institutions created in order to support small business, the concrete action and result were very limited in scope till the early 1980s. As reported by the Korean Development Institute (Lee, Urata and Choi, 1986), big industrial concentration combined with massive public support did restrict the level of open competition and the opportunities of initiating small private business, but competition was also constrained by many business and trade associations (formal and informal), acting as bridges between government and entrepreneurs for the implementation of state industrial policies: there were 95 in 1970 and over 235 in 1982 (Lee and Lee, 1982), most established by special laws (like the cooperatives of small firms), acting under government guidance, and having big firms as key members. They would quite often enter questionable actions in terms of unfair business practises, restrict the number of newcomers in one industry, and even favour cartel-type decisions.

One can ask how small business entrepreneurship might have been virtually promoted through pure bureaucratic and public legislation, or whether it would have survived and even developped in any case because of induced rapid economic growth during this period. As noted by Michell (1988, p. 82) and shown by statistical data, there has been an obvious dynamism of small firms in Korea even during the seventies, despite much government support and distortions in favour of big business. During the twenty years 1960—80, small business contribution to the global economy remained fairly stable which is an achievement in itself: small firms increased their exports and retained most of their share in terms of domestic production and employment (37% to 32% of total labour). These three indicators had sharply decreased between 1960—75, but the trend was inverted for the period 1975—85. The increasing imbrication between small and big firms through various types of subcontracting seems to have followed much of the Japanese model, compared to Taiwan and Hong Kong where the majority of small enterprises are far more autonomous and react directly to international market niches.[2]

5. Korean small business in the 1980s and future perspectives

Since the early 1980s, the slow down of the world economy and international demand has revealed a certain vulnerability of the export-centred and big scale industrial structure of Korea, after a decade of over-investment in the heavy and chemical industries partly related to the accumulation of excessive foreign debts by both the public and private sectors. Then, the mid-1980s brought a second series of problems following the rise of international currency and trade pressures (especially against Japan and the Asian NIEs) and severe political and social unrest in the big industry at home. The Fifth Republic of Korea had to become more aware of the necessity to foster small business as one important basis of the economy. This was recognized in the new Constitution (article 124—2), in the revision and extension of most previous laws dealing with small business, and again in the Presidential Commission Report on Economic Restructuring of 1988. A long term plan for the promotion of small business has been launched for the period 1982—91 with quite ambitious targets: the small firm contribution to total value added and to total employment is expected to increase from 35.4% to 44.8% and from 47.7 to 54.3% respectively between 1982 and 1991. For the first time, the promotion of small business was not only envisaged through reinforced measures of public assistance but also through the reaction of a global economic climate in favour of more spontaneous entrepreneurship. After all, everybody could be willing to be its own boss in Korea (like in Hong Kong or Taiwan, or at least like in Japan) if not hampered by decades of government guided constraints imposed on private initiative. It is not at all so sure that South Chinese culture and mentality are more conducive towards small private entrepreneurship than in Korea or anywhere else. Culture and mentality, but also business and government environment have a strong role to play in the emergence or nonemergence of small entrepreneurship.

5.1 *The major instruments of government policy*

Since 1983, the Korean government has been trying to develop operational collaborations and working networks between all the organizations fully or partly in charge of supporting small business. About 70 of such organizations, mainly public or semi-public, were registered! Despite very limited action in favour of small firms during the last decades, this figure gives an other indication of the centralized and bureaucratic approach of the Korean authorities up till very recently.

There are three major agencies or semi-public institutions promoting SMEs in Korea. *The Small and Medium Industry Bureau*, a division of the Ministry of Trade and Industry, is responsible for the overall coordination and implementation of government policies for SMEs; *The Korea Federation of Small Business* (established in 1962) is responsible for small business cooperatives throughout the country, especially in rural areas and regional industrial parks. It federates about 25 000 small and medium-sized firms, and is supposed to offer government subsidized grants, loans, and tax exemptions. Compared to the Federation of Korean Industry or the Korean Foreign Trade Association (KFTA), which are two of the most powerful business organizations in the country and very much dominated by big firms and top government circles, KFSB has much fewer resources and has not been very operational for many years. This is obviously changing now: for instance, KFSB has hosted the 17th Annual International Small Business Congress in Seoul on September 16—19, 1990. SMIPC, (established in 1979, with 6 regional offices throughout the country and 3 representative offices overseas in Japan, Europe and United States) has become the central and operational agency for the promotion of small firms. It carries out a wide range of concrete financial and technical assistance programs for them, also through its affiliated Small Business Trading Institute, and tries to coordinate various actions together with some of the 70 or more organizations fully or partly in charge of small business promotion, like for instance the Korean Development Institute or the Korean Institute for Economics and Technology (Seoul) in the field of economic research and training. SMIPC is also responsible to promote the internationalization of SMEs through joint ventures with foreign partners.

5.2 *Key issues for small firms in Korea*

Entrepreneurship and human resources

During the colonial period till World War II, a group of small indigenous entrepreneurs emerged during the 1930s. After the wars, Korea had little human resources and existing experience to start up business on a medium or big scale, and this certainly explains the leading economic role of both government and foreign investment up to recent time. Until 1987, there was no real policy to promote private entrepreneurship: a first law promoting small business initiatives was adopted in 1986 but its concrete implementation has been slow, partly because of a lack of experienced staff. There is still very limited data about the profile of small entrepreneurs in Korea and in the absence of in depth field research, a few general informations can still be collected. Most of small entrepreneurs are in their 40s, and have received a secondary education, if not more. Over 80% had a previous on the job experience of several years as middle ranking or senior executives in manufacturing big firms, essentially in engineering but rarely in management. Just a few of them (20%) have a small business family background and most of them belong to the first generation of small entrepreneurs. The fact that subcontracting represents a good two thirds of the total activity of small business is a clear illustration of the fact that so many new entrepreneurs have previously worked for big firms: some of them have spontaneously decided to become their own boss, but many big firms, acting as trustees providing capital and technological support, have also encouraged many of them to start various types of small or medium-sized subcontracting. There is obviously now a coming second generation made of very young men, highly educated in American, Japanese or Korean universities, and who might look and sound as the first modern small entrepreneurs. Many of them are quite open to risk taking, even if their chances of business success are limited. They tend to push their sons in some fields of study, which are different from their own business, simply because they are not too sure that their own company will remain prosperous in the long run.

If we turn now to white and blue collars, especially in small companies especially under 50—70 employees, they have to cope with major difficulties in being able to recruit experienced or well trained intermediary staff or even very skilled labour. The situation is slightly better in medium-sized firms, but on the whole young technicians do not feel very much attracted by the low standard of working conditions there. The labor environment is a third and important issue. Labor unrest and strong wage demands have been more and more frequent during the last years, even if politics and trade unionism are much less present in small firms compared to big ones. Much of the recruitment still goes through clientelism and paternalism, in small or very small business in particular. Despite small wage differential by firm size, labor prefers big companies, mainly because of non-wage factors (stability of the job, social welfare, training facilities, social prestige). Manpower is generally of average or high quality, especially in terms of motivation and hard working but staff turn over is rapid, mainly in such urban and industrial areas. Vocational training needs much improvement in the future, except in the chaebols and some other big firms, where on the job training is already much in practise.

5.3 *Small business finance*

Compared to Japan, Korean small entrepreneurs usually start their business with very limited capital available (less than 30—40% of total amount needed), but they seem to have rather good business ideas for finding niches despite market domination by foreign and local big firms. Only 20% of all existing small firms are limited companies, a type of business encouraged by taxation exemption and preferential loans, but most small firms are still in sole ownership and family run. Even if very distorted, the business environment is very competitive: among the most promising small enterprises selected each year by the government, about 25% have however gone bankrupt, especially in the last 3—4 years in relation with changing economic conditions at home and worldwide. Till the mid-80s, the starting up of a new business was also administratively and financially difficult: with too much inspiration derived from Japanese business law, the local legislation required a good three hundred documents, which have been reduced to about 50 today.

The principal financial concern is the difficult access to credit, and the obligation to provide sufficient garanty and collateral to money lenders. For cultural reasons and because of the priority given to big scale exporting industry, small entrepreneurs have faced many difficulties in relying on institutionalized financial establishments and they have looked for funding from the underground market (ranging from family or friends' alliances — in the Asian sense — to non official and expensive money dealers).

The banking community has remained till recently very conservative in the field of small business promotion, judged as risky (lack of collateral) and unprofitable. Banks were also state run and did not know much about the conditions of private entrepreneurship; therefore they preferred to focus on big companies and their subcontracting firms (compact and vertical industrial integration) in close accordance with government industrial plans. Except in one or two cases, the banks have been very ignorant of the realities of small firms and they have not even respected in practise the government regulations imposing on them a minimum percentage of their total loans to be channeled to existing new small firms. *The Industrial Bank of Korea* (the former Small and Medium Industry Bank created in 1961), and *the Citizen National Bank* are two major specialized state banks providing small enterprises with specific credit facilities at the national level (IBK concentrates on medium-sized firms, CNB on small firms under 100 employees). They are particularly responsible for implementing government guidelines which require commercial lending institutions to supply a minimum percentage of total loans to small firms: 35% and 80% of total corporate loans for commercial and local banks respectively, 35% of total discounted bills for finance companies, 25% of leasing contract amounts for merchant banks. But in practise, all institutional bankers have applied a rather loose definition of small and medium-sized enterprises, often up to 800/1 000 employees and up to 12 billion won in total fixed assets, and small or very small firms have been more or less ignored. CNB has always complained that the demand of loans by small firms was far superior to the supply made available by the government sectoral and selective allocation of credit facilities, and most significant allocation decisions have remained in the hands of banks' presidents and vice-presidents. Officially total outstanding loans to small firms reached 25.43 billion US dollars in 1988 (7 billion by IBK alone), accounting for 48.3% of total loans provided to Korean enterprises throughout the country. In 1986 for instance, it was estimated that the small manufacturing business had mobilized 46.8% of the necessary amount for equipment investment through financial institutions, while 45.5% came through other resources (Citizens National Bank, 1988).

Apart from banks or the underground money lenders, small firms can also try to get financial back up from other sources. The *Korean Credit Guarantee Fund* has been created in 1976 to serve initially both the needs of large and small firms having no or little collateral to offer, but 40% of its guarantees issued were required to support small business. Since 1982, KCGF is supposed to work exclusively for them. For most types of banking loans, even IBK or CNB can ask for the fixed assets of a small firm in guarantee up to 40% of the total credit amount; government statistics provide every year some evaluation figures of fixed assets for each company, but it is difficult to assess how far they are reliable. Out of the total of loans distributed to small firms, over 18% of them were guaranteed in 1987 against 9% in 1977. Special government funds have been set up and managed by SMIPC or other agencies to support those small firms facing various conjonctural difficulties, but the money has gone primarily to the small firms selected by the Ministry of Trade and Industry, especially in the field of subcontracting to big firms.

Officially, or underground, the big chaebols and other large firms have been substantial suppliers of capital and skills to their closest subcontractors, and this trend should develop further in the near future considering current attempts in favour of business deconcentration and deregulation. On their part, the cooperatives of small firms, affiliated to the Federation of Small Business, have brought limited financial support of their own till the mid-80s. However, they are quite active to promote very small firms in the provinces and regions.

While small firms make still very little use of stock market financing (Small and Medium Industry Bank, 1983), the idea to create another specialized bank dealing with small business exclusively has been rejected so far in favour of a more efficient and operational use of all existing agencies and programmes.

Venture capital financing has started to develop as a flexible instrument to promote free enterprise, especially for small firms which are technology oriented (Yun, 1988). This new development is based on two laws of 1986, the Small and Medium-sized Venture Business Creation Act, administered by the Ministry of Trade and Industry, and the Venture Capital Industry Promotion Act, administered by the Ministry of Finance. A small company established under the first law is allowed to invest in small businesses in the form of equity and in the start-up operation (a few ten companies established so far). A company established under the second law can undertake equity and loan investment in new technology, consulting services, leasing and factoring, ... (currently 4 companies have been allowed to carry such operations). All these companies are not absolutely identical to those existing in most OECD countries: they have received initial funds or preferential treatments from the government, but they are privately owned and managed.

5.4 *The access of small firms to technology*

The overall quality of production equipment and technology is very low among most Korean small firms. Most of the research and development activity is performed by large firms, when not imported mainly from Japan and USA, and only 16 to 18% of all small firms seem to be formally engaged in R&D investment of some kind (Small and Medium Industry Bank, 1984). This does not mean that many entrepreneurs, especially in the young generation often trained abroad and traveling worldwide, do not consider technology as one of their top priorities for improving the quality and standards of their production. Most of their technology learning has been derived from various subcontracting contacts with bigger firms, which are becoming more and more numerous following the rapid diversification and sophistication of the Korean economy and of its big conglomerates. Internationally, Korean small firms have received about 44% of all technology transfers from abroad (against 56% to large firms) during the period of 1962—87 (Ministry of Science and Technology, 1987), which is a rather impressive and unexpected figure. The majority of small firms asking for technology support from state run SMIPC or related agencies tend to suffer more problems of human and financial management than problems purely related to technology. In the last years, the import of high technology from abroad by Korean big firms has met rising resistance from industrialized nations, including Japan, whereas there is perhaps more flexibility for small enterprises to enter high technology niches, through joint-ventures with foreigners.

A first example can be chosen among those local small firms supplying the car industry with components and parts, which hardly invest in research and technology and copy mainly existing items in Japan or USA. In a period of sharp increasing demand but also of competitive offer of auto-parts on world markets, these small firms will be able either to expand drastically to meet production and quality capacity, or most of them will collapse by their failure to match international standards imposed by Japanese and Western multinational car makers (Lee, 1987).

The example of those small firms supplying the machinery industry shows that they are probably even less involved in technology upgrading. More than two thirds of all subcontractors have very little management experience and enough technical expertise to implement new machinery technologies without enormous difficulties: these small firm managers do not have very specialized engineering backgrounds, they cannot or do not recruit highly skilled personnel able to develop technology and innovation, and they do not like or envisage direct support such as technical advisors dispatched to them by big contractors or state agencies. The contractors have also a good share of responsibility by offering too little operational guidance and support to small firms or by giving their preference to imported parts.

6. Subcontracting at home and small business internationalization process

6.1 *Subcontracting at home versus overseas*

According to Park (1989, pp. 297—301), the accelerated big scale industrialization process since the 60s has produced two types of relations between big and smaller firms. First, the chaebols and other big firms have rapidly expanded, partly through the absorption of and merger with various existing small firms, in all kinds of sectors and sub-sectors. This trend was much reinforced from the mid-1970s (General Trading Act, 1976) with the emergence of big trading houses supported by the state and serving the rising penetration of Korean exports on world markets. No doubt that the overall contribution of small enterprises to the economy declined precisely during this period. Then, during a second phase of diversification and sophistication of the Korean economy up till now, the number of smaller companies affiliated to big conglomerates has developped (53 on average for each chaebol in 1983 against 14 in 1978), and various types of subcontracting have flourished, induced by large firms to existing small firms or new ones. Compared to Taiwan or Hong Kong, the most promising Korean small enterprises are not part of a horizontal industrial system where there are plenty of autonomous small firms reacting to international or domestic offer and demand. Instead they are part of a compact and vertical system together with big firms (with similarities in Japan). Considering the further growth of the Korean chaebols in 1988—90, it is very likely that the future development of small firms will continue to be mainly induced by the big firms. This leaves perhaps less room in Korea than elsewhere for a rapid expansion of autonomous small and medium-sized firms.

During the 1970s, subcontracting represented more or less 20% of the total output of small firms: it was not only a modest and stable contribution to the big scale economy, but large firms (mainly preoccupied by selling final goods at low price) also imposed all kinds of delivery and financial constraints on small business despite contrary regulations adopted by law. This was not only true for the final output of small firms, but also for some of their imputs depending on domestic or imported goods and material supplied by big firms and trading companies. Since the amount of subsidized financing granted to exporters was based on total export revenue rather than on net profit or value added, big exporters had little incentive to produce intermediate goods. It took a long time before the authorities started to realize that by developing small and medium-size parts industries, Korea's value added in exports would increase , and that the country would not have then to export as much to yield the same amount of net profit and foreign exchange (Chon, 1990). During the 80s and for reasons already mentioned, subcontracting has multiplied rapidly, especially in some equipment and technology oriented industries where the needs for quality components and parts are becoming enormous: the total number of manufacturing small firms engaged in subcontracting has grown up from 16% in 1980 to 38% in 1986! In 1988, subcontracting was estimated to represent over 60% of total small business output in car manufacturing, 40% and 38% in electronics and machinery respectively.[3] The big firms are no longer exclusively interested in buying at low cost from small firms, and they even complain that the development and level of subcontracting do not follow fast enough the evolution of their demands (meaning to much import dependancy). Some big contractors begin to realize that to impose their decisions to small firms might be positive in the short-run in order to remain competitive on world markets, but, in the long run, it can affect in many ways both the potential of small firms and the very competitiveness of big firms. In order to promote closer cooperation and transfers of know how between big and small firms, some subcontracting business associations have been recently initiated by some of the big conglomerates in heavy industries, car and electronics productions: more than 7 000 subcontractors were registered in 1987 in about 65 to 70 such associations, the largest associations having each 100 to 200 affiliated small enterprises (186 for Daewoo for instance).

Subcontracting has mainly been based on big orders from the large scale industry and it has produced a very segmented answer among various small firms dividing and sub-dividing the initial cake. This kind of division of labour has often created difficulties related to the lack of operational coordination between subcontractors, which affects both the quantity and quality of the goods delivered to the big customer. The enormous size of orders has also pushed many small enterprises to expand their capacity and to get banking support against such orders, but these small firms would face major problems and even disappear in case of sudden slow downs in orders as it was observed in electronics in the mid-80s. Because of strong subcontracting orders from the chaebols, small firms have not been able to develop the production flexibility of their Taiwanese counterparts and they have probably been more inhibited than in Japan, from where the model of compact industries was however drawn.

Just a few examples might illustrate some of the above comments. As well detailed by Lee (1987), the subcontracting system in the automotive industry has not yet gone beyond a single-stage division of labour. If local small firms may feel free in principle to supply several big scale assembly firms, more than 53% of them (a total of 800 small firms in 1987) have an exclusive relationship with only one, and another 20% with only two. This is very different either from Japan, where there is a strong multi-stage and multi-directional vertical division of labour, or from USA, where division of tasks is horizontal and quite egalitarian between main assemblers and specialized suppliers, also working for non automotive industries. As presented by J. W. Kim (1983), the case of Korea's machinery industry is another example of single-stage division of labour between major contractors and subcontracting small firms. As this branch of industry is still relatively underdeveloped (compared to car or heavy industries), neither contractors nor subcontractors like to work with a multiple stage structure of production involving second or third order small subcontracting firms, which are poorly considered because of the unreliability of their supplies and the low degree of their specialization. Since the subcontracting market is still rather small, big firms and subcontractors tend to keep a variety of productions within themselves. Compared to Japan or other industrialized nations, it seems that there is little correlation between machinery subcontracting success and the age of the subcontracting firm; the most active small firms are even those established since the late 70s/early 80s putting more emphasis on light industry and economic diversification.

All these informations gathered in the field of qualitative production/technology and subcontracting tend to indicate that the Japanese type of vertical and multiple subcontracting systematization, which emphasizes capital/technology/expertise/personnel close links between contractors and subcontractors, does not exist much yet in Korea. The debate is whether it is totally transferable or not, and whether Korean big and small firms will prefer to go their own way between the Japanese or Taiwanese models.

6.2 *Internationalization of Korean small firms*

Since the 60s and 70s, the Japanese conglomerates have progressively expanded their direct presence overseas in both the developed and underdeveloped nations. Because of rapid currency appreciation and increasing trade pressures since the mid-80s, this trend has not only been reinforced but a lot of Japanese small firms have begun in their turn to internationalize, first through the subcontracting networks of Japanese big firms, then, after some first experience, on a more autonomous basis. Little doubt that similar moves should be expected from the Asian NIEs in the next years, especially from Korea and Taiwan. Because of rising production costs and social unrest at home, mounting monetary and trade pressures from OECD countries, and new regional market developments in Europe and America, the big Korean chaebols and some other labor intensive industries have started to diversify their foreign markets and to delocalize overseas some segments of their productions. Even if statistics still show modest figures, some Korean small firms have also started to invest overseas (32 million US$ officially registered in 1988 against almost zero in the early 80s, with a sharp acceleration since 1986) or to look for more foreign imputs at home. No doubt that the most promising small firms are looking today for much closer relations with OECD partners in international trade, technology, know how and even financial venturing.

There is much scope for future research in the field of existing and potential internationalization

TABLE IV
Investment Overseas by Korean Small and Medium-sized Firms in 1988. (in '000 US$)

	Japan/SE Asia	N. America	L. America	Others
Manufacturing	4,550	12,591	4,287	2,003
Trade services	1,813	2,579	0	1,925
Other sectors	514	1,505	242	150
TOTAL	6,877	16,675	4,529	4,078

Source: Central Bank of Korea, August 1989 (investment over 1 million US$ must be declared)

of Korean small firms, especially in the following areas:

Firstly, a detailed knowledge of the real capacities of the local small firms in the different strong sectors of the Korean economy is absolutely necessary to make evaluations and prospecting into the future, and all the official and grey documents made available by the government and semi-public agencies might be very insufficient. So far, the small firm already represented overseas are mainly those looking for low production costs in Southeast and Northeast Asia (textile and clothing, footwear, plastics, simple electronic parts) or for marketing channels to big regional markets in North and Central America (electronics). Eastern and Southern Europe could be another target in the near future.

Secondly, a detailed evaluation of the types of potential small business activities to be internationalized is also necessary in several areas like trade of goods and services, technology and know how, finance and investment.

Thirdly, the above evaluation has to be combined with a geographic differentiation of existing and potential partnerships with foreigners, both big and small-medium sized firms. Much emphasis should be put on the two giant partners of Korea, Japan and USA, but also on the rest of Asia (China and ASEAN countries in particular), Europe, and the Middle East.

Finally, many questions should be addressed whether the best instruments and means have already been set up or not in Korea in order to promote the future internationalization of small firms. Apart from those very promising small enterprises, which can do or have already done most of the job by themselves (especially medium-sized ones) but which are not very numerous compared to Taiwanese or Hong Kong small and medium-sized firms, the majority of the local small enterprises and their potential foreign partners could use several instruments like existing/future economic research dealing with industrial subcontracting in manufacturing or in services existing expertise and know how made available, though on a costly and confidential basis, from local and foreign consulting firms and also from the public and private universities in Seoul where the quality and social position of senior scholars (often trained in Japan and USA) are highly considered; existing expertise and on going assistance programs from the most reliable semi-public agencies mainly the Industrial Bank of Korea and the Small and Medium Industry Promotion Corporation. SMIPC is particularly involved with the international promotion of small firms from both its headquarters in Seoul and its overseas offices (Frankfurt, Tokyo, Chicago). SMIPC Centre for Foreign Investment Services is in charge of foreign joint ventures with small enterprises in Korea and has implemented so far special investment programs with Japan, USA, West Germany, France, and United Kingdom. SMIPC Centre for Overseas Investment Services advises Korean SMEs looking for investment abroad and it provides various tax incentives and overseas investment insurance schemes in association with Korean Exim Bank.

Notes

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[1] See also Choi (1970).
[2] The period 1975—85 is one of strong consolidation of the chaebols. All but three from the 1975 list of the top ten chaebols have maintained their top position in 1985 (see Jung, 1988).
[3] Based on an interview with Mr. Chang Boon Yoon of the Korea Institute for Economics and Technology, in August 1988.

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