

Small-and Medium-Sized Enterprises Promotion Policy and Economic Development of Korea

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Abstract: The Korean government supported large conglomerates called *chaebols* during the period of rapid economic growth. Despite the rapid economic growth, structural problems such as the imbalance between *chaebols* and small- and medium-sized (SMEs) enterprises intensified. From the 1980s the government began to take concrete SME promotion measures. Consequently, the proportion of SMEs in the Korean economy began to increase. The government's current SME promotion measures comprise financial and tax incentives as well as new industrial policy measures. Korea's experience provides important policy implications to developing countries that try to achieve rapid economic growth and structural development.

Introduction

The Korean economy went through a period of rapid economic growth from the 1960s. During the early 1960s - the mid-1990s, it showed the highest economic growth rate in the world (Beck, 1998: 1018). Korea, which used to be one of the poorest countries in the world during the 1950s, became a member of the Organization for Economic Co-operation and Development (OECD) in 1996. The rapid post-war reconstruction and development of the Korean economy during the latter half of the twentieth century in general went hand in hand with the development of the family-owned large conglomerates called *chaebols*, such as Samsung, Hyundai and LG.¹ The Korean government pursued the Heavy and Chemical Industries (HCI) promotion policy during the 1970s. Since HCI can be characterized by economies of scale, *chaebols* rather than small- and medium-sized enterprises (SMEs) became the main beneficiaries of the HCI promotion policy of the Korean government (Mah, 2007).

As policy loans at preferential interest rates continued to be provided to *chaebols* through the government's control of commercial banks in the 1970s and 1980s, *chaebols'* debt-equity ratios rose. As a result of the balance of payments crisis in late 1997, the Korean economy was driven to a technical default situation. Several debt-ridden *chaebols* including the then third largest *chaebol*, Daewoo, became

bankrupt in the late 1990s. The rescue package prepared by the International Monetary Fund (IMF) in 1998 was accompanied by the corporate sector reform, privatization of state-owned-enterprises, and the welcoming of foreign direct investment (FDI) inflows, among others. Realizing the structural problems arising from too much reliance on *chaebols*, the Korean government undertook corporate restructuring as a part of economic reform in the process of overcoming the economic crisis in the late 1990s. Due to the corporate sector reform measures, the surviving *chaebols*' debt situation improved somewhat (Mah, 2006).

Faced with a limit to further economic development as a result of the previous *chaebols*-led economic development strategy, in the late 1990s and early 2000s the Korean government tried hard to invigorate the economy through the promotion of venture businesses. Since then, the government has focused on the role of SMEs, although the performances so far may be controversial. The President of Korea, Moon Jae-In, newly elected in 2017, has continued to develop this emphasis on the role of SMEs in the Korean economy and established a separate ministry in charge of SMEs and venture businesses, the Ministry of SMEs and Start-ups, in mid-2017. This paper explains the evolution of SMEs in Korea, analyzes the situation which induced the policies supporting SMEs, evaluates their performance in the economic development of Korea and derives policy implications for developing countries.

Transition to the SMEs-centred Economic Development

The Korean government provided policy loans at interest rates significantly lower than the commercial lending rates to *chaebols*, particularly during the 1970s and early 1980s in the process of pursuing the HCI promotion policy. The HCI sector, including the chemical, automobile, electronics, iron and steel, and shipbuilding industries, could be characterized by economies of scale. Therefore, *chaebols* were able to benefit from the HCI promotion policy pursued by the government. The rapid economic growth of the Korean economy during the 1970s and 1980s was accompanied by a rapid growth of *chaebols* (Mah, 2007). It was not long ago that many had projected great hopes and expectations for the *chaebols* to make Korea 'Asia's Next Giant' (Amsden, 1989). Thanks to the *chaebol*-friendly policies, *chaebols* have enjoyed ready access to bank loans. With ready credit, they expanded haphazardly into various industries. This resulted in the accumulation of huge debts (Pollack, 1997). The bankruptcies of several debt-ridden *chaebols* in 1997–1998 have led many to reconsider the role of *chaebols* in the Korean economy.

Although, previously, many social scientists regarded *chaebols* as the economic locomotives that enabled Korea to rise from a war-torn poorest country to one of the OECD Members (Lim, 2002), the symbiotic relationship of the *chaebols* and the government began to be seriously criticized. For instance, Lee (2000: 3) attributed the economic crisis in the late 1990s to the government–*chaebols* collusion. According to him, the *chaebols*-led economic growth contributed to expanding the size of the economy, while it was accompanied by structural problems. The government began to emphasize the role of SMEs in the economic development of Korea. Government policy led to many financial institutions increasing their loans to the SMEs while reducing loans to *chaebols*. In the process of overcoming the economic crisis, the importance of the growth of SMEs was highlighted and policies supporting SMEs began to be emphasized (Harvie and Lee, 2002).

Although the Korean economy had been perceived as a *chaebols*-led economy, SMEs accounted for 80.6 percent of the total number of employees in Korea in 2000, as Table 1 shows. The ratio of workers employed in SMEs rose during the 2000s and since the mid-2000s this has increased to 87–88 percent. It also shows the declining share of *chaebols* in the number of firms in the Korean economy. In terms of the number of firms, SMEs shared 99.9 percent of all firms in Korea since 2005. In 2014, SMEs accounted for 37.5 percent of total exports and 51.2 percent of value added (Korea Federation of SMEs (KBiz), 2016).

Table 1: Number of Korean SMEs and Employees by Year

| year | all firms (A) | | SMEs (B) | | ratio (B/A) (per cent) | |
|------|-----------------|---------------------|-----------------|---------------------|---------------------------|---------------------|
| | number of firms | number of employees | number of firms | number of employees | number of firms | number of employees |
| 2000 | 2,729,957 | 10,768,597 | 2,707,805 | 8,680,694 | 99.2 | 80.6 |
| 2005 | 2,867,749 | 11,902,400 | 2,863,583 | 10,449,182 | 99.9 | 87.8 |
| 2010 | 3,125,457 | 14,135,234 | 3,122,332 | 12,262,535 | 99.9 | 86.8 |
| 2014 | 3,545,473 | 15,962,745 | 3,542,350 | 14,027,636 | 99.9 | 87.9 |

Source: National Statistical Office (2014)

Table 2 shows the changes in the share of value added in the manufacturing sector produced by SMEs since 1980. The share accounted for by SMEs in the manufacturing sector increased from a mere 35.3 percent in 1980 to 44.3 percent in 1990. That is, although *chaebols* had been known as the driver of the economic growth of Korea, such an explanation became less convincing beginning from

the 1980s. As several *chaebols* went bankrupt in the midst of the economic crisis in the late 1990s, the SMEs' contribution to the value added in the manufacturing sector further increased to 50.2 percent in 2000. It was recorded as 49.5 percent in 2013 (KBiz, 2015).

Table 2: Value Added in the Manufacturing Sector

(unit: US\$ billion, percent)

| <i>year</i> | <i>all firms (A)</i> | <i>SMEs (B)</i> | <i>B/A</i> |
|-------------|----------------------|-----------------|------------|
| 1980 | 19.6 | 6.9 | 35.3 |
| 1990 | 99.6 | 44.1 | 44.3 |
| 2000 | 194.0 | 97.4 | 50.2 |
| 2010 | 393.4 | 186.6 | 47.4 |
| 2013 | 457.8 | 226.6 | 49.5 |

Source: Korea Federation of SMEs (2015)

The significant rise in the share of SMEs in the manufacturing sector can be compared with that in all industries. For instance, Table 3 shows that the contribution of large firms in the Korean economy as a whole in terms of value added continued to increase from as low as 35.7 percent during the 1970s to 47.7 percent in the 1980s. It remained between 50 and 51 percent during the 1990s and 2000s, while it jumped to 69.7 percent during 2010–2013, which shows that large firms have recently continued to diversify further to the service sector, including restaurants and convenience stores. Compared with this, the share of SMEs can be said to have increased in the manufacturing sector since the 1980s (Mah, 2016).

Table 3: Value-Added by Firm Size in All Industries (unit: percent)

| <i>firms</i> | <i>1970</i> <i>-1979</i> | <i>1980</i> <i>-1989</i> | <i>1990</i> <i>-1999</i> | <i>2000</i> <i>-2009</i> | <i>2010</i> <i>-2013</i> |
|--------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| large firms | 35.7 | 47.7 | 50.5 | 50.8 | 69.7 |
| SMEs | 64.3 | 52.3 | 49.5 | 49.2 | 30.3 |

Source: Korea Federation of SMEs (2015)

Financial and Tax Incentives as SMEs Promotion Policy Measures

Direction of the SMEs Promotion Policy

Concerns about the SMEs are expressed in Article 123 of the Constitution, which stipulates that: "The state should protect and promote Small- and Medium-

sized Enterprises.” The Framework Act on Small- and Medium-sized Enterprises was legislated in 1966. Meanwhile, during the 1970s the government’s emphasis was placed on promoting the HCIs. Literally, the SMEs played only a supplementary role assisting *chaebols* (Kim, 1991). The government placed an emphasis on *chaebols* as the engine of economic growth, mostly because of their export potential. Policy measures favourable to *chaebols* included provision of subsidies and loans from the financial market, among others (Bakiewicz, 2008: 48). Nevertheless, during the period of remarkable economic growth, there were undesirable side effects, including a deepening of wealth inequality, increasing dependency on foreign capital and technology, and a widening of the economic gap between *chaebols* and the SMEs (Kim, 1991).

The Korean government started to express its concern about the heavy dependence on *chaebols* and began promoting SMEs to remedy the problems arising from it. This was reflected by the SMEs Promotion Act, which was legislated in 1978. The Korean government regards this as the first Act reflecting the modern feature of the legislation covering SMEs. The purpose of this Act was to strengthen the competitiveness of SMEs through their structural advancement, and to expand their business areas, thereby contributing to the balanced development of the national economy (The Ministry of Government Legislation in Korea (MGL), 2013). Meanwhile, since the Act was not accompanied by concrete measures to help achieve this, it could still be regarded as a symbolic gesture.

As of the early 1980s, the government realized the problems of heavy reliance on *chaebols* and the beneficial role of SMEs, which can quickly respond to changes in the market condition and are likely to be more innovative compared to *chaebols* (Lee, 2010). Consequently, the government began to pay attention to the development of SMEs and it legislated the Act on the Facilitation of the Purchase of Products Made by SMEs and Support for Development of Their Markets in 1981. This aimed to contribute to the enhancement of the competitiveness and the management stability of SMEs (MGL, 2013). With the 1981 Act, the Korean government began to take concrete measures of pursuing the balanced growth between *chaebols* and SMEs, particularly in light industries. As a result, the share of SMEs in total exports increased from 27 percent in 1985 to 45 percent in 1990 (Lee, 2010).

Laws and institutions supporting promotion of SMEs were strengthened during the 1990s. The SMEs Promotion Act legislated in 1994 specified the improvement of the structure of SMEs by strengthening the management base

of SMEs, the establishment of the Small and Medium Business Corporation (SBC) and the SME Establishment and Promotion Fund. The Small- and Medium- Business Administration (SMBA) was established in 1996 as the government authority fully devoted itself to planning and implementing programmes contributing to the development of SMEs. The SMBA maintains schemes that target assisting SMEs in the areas of entrepreneurship, human resources, financing, marketing and innovation. One of those schemes is Inno-Biz, a label given to technologically innovative and competitive SMEs with future growth potential. The government provides such SMEs with financing, technology and marketing support. This scheme is intended to select and support innovative businesses that are self-sustainable and can compete on global markets with the world's leading firms (OECD, 2010: 78; Yang and Choi, 2013). To encourage people to establish a new firm, the SMBA is continuously arranging and carrying out exit strategies, including mergers and acquisitions (M&As) and public offerings, as well as reducing regulations (Business Korea, 2016).

The government established the Korea Securities Dealers Automated Quotation market in 1996, which provided SMEs opportunities for equity financing (Mah, 2016). After going through the economic crisis, the government established the Small Business and Entrepreneurship Promotion Fund to support the improvement of SMEs' business environment and the business transition of disadvantaged SME owners. The resources of the fund consist of contributions from the government and lottery revenues (MGL, 2013).

The current SME promotion measures implemented by the government comprise financial incentives, tax incentives, measures strengthening human resources, infrastructure, provision of information to SMEs, and networking large firms with SMEs. Of these various kinds of policy measures, financial and tax incentives have been regarded as the traditional industrial policy measures.

Financial Incentives

Despite the rising importance of SMEs in developing new industries and creating jobs, most SMEs face the lack of funding, manpower, and technical expertise. Due to a lack of collateral, short credit history and a lack of expertise needed to produce financial statements, SMEs' access to credit is limited compared to large companies. The cost of lending to the former is relatively large, as it is difficult and costly to obtain information about them and they are less reliable than the latter (OECD, 2010: 6). According to Lee (2017), insufficient collateral, a high risk of default, high transaction costs, and asymmetric information resulted

in SMEs' limited access to finance, credit allocation by banks, being subjected to high interest rates, and a lack of long-term financing. To solve the imbalance between SMEs and large companies, the Korean government has provided financial incentives to SMEs through credit guarantees and lending at preferential interest rates.

Credit Guarantees

A credit guarantee provides guarantees to lenders to cover the default risks of lending to SMEs. Thus, it can promote bank lending to SMEs. It is known as the most effective and market-friendly government intervention in SME financing. The credit guarantee scheme started in 1961 with the enactment of the Law on SME Banks, which led to the establishment of the Credit Guarantee Reserve Fund. The Korea Credit Guarantee Fund Act was legislated in 1974 and the Korea Credit Guarantee Fund (KODIT) was established in 1976. Thus, the credit guarantee scheme was mainly prepared in the mid-1970s. The government established the Korea Technology Finance Corporation (KOTEC) in 1989 to provide credit guarantee to firms – mainly SMEs without the appropriate collateral, with good technologies. In 2000, the Federation of Credit Guarantee Foundation (KOREG) was established, which is an association of 16 regional guarantee foundations (Lee, 2017).

As of 2017, three public financial institutions are in charge of providing credit guarantees to SMEs. KODIT supports SMEs not related to advanced technologies, startups, exporting firms and greengrowth-related firms. KOTEC serves technology-oriented SMEs, venture firms, Inno-Biz firms, and greengrowth-related firms. KOREG supports regional micro-businesses, small firms, self-managed and unregistered micro-businesses (Jung and Lim, 2016). In addition to those, SBC also provides credit guarantees to SMEs. During 2007–2011, public support in the form of credit guarantees amounted to 100 trillion Korean won, about 8 percent of GDP in 2011, which can be compared with the amount of direct lending during the same period – 42 trillion Korean won. In 2011, the ceiling on the amount of credit guarantees was raised from 85 percent of the amount of lending to 100 percent (Board of Audit and Inspection, 2012).

Of the financial institutions providing credit guarantees, KODIT gets its funding from the government, banks and others. Table 4 shows the amount of loan provided by commercial banks to SMEs and the percentage of loans guaranteed by KODIT in the total amount of loans. Since the establishment of

KODIT, the proportion of credit guarantees provided to SMEs increased from 35.7 percent in 1975 to 77.3 percent in 2015 (Lee, 2017). In 2016, KODIT newly provided credit guarantees of as much as 11.8 trillion Korean won (US\$9.8 billion) (KODIT, 2017).

Table 4: Changes of SME Loans and Guarantees over SME Loans

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|-----------------------------------|------|------|------|------|------|------|------|------|------|------|
| SME loans (US\$ billion) | 262 | 321 | 267 | 286 | 384 | 396 | 401 | 423 | 453 | 501 |
| Credit guarantee (per cent) | 13.4 | 11.0 | 10.6 | 13.9 | 14.7 | 14.2 | 14.3 | 14.4 | 13.5 | 12.7 |

Note: US\$ = 1,150 Korean won exchange rate is assumed throughout the period.

Source: KODIT (2017)

KOTEC, established in 1989, is a non-profit government agency responsible for operating the loan guarantee scheme specifically for SMEs and venture businesses with competitive technology and business prospects with potential but that would not qualify for a loan under a normal credit analysis because of low collateral. KOTEC gets its funding from fees paid by financial institutions for the guarantee service and from guarantee fees paid by companies (O'Donnell, 2012). The amount of guarantees offered by KOTEC increased from 16.9 trillion Korean won (US\$15.3 billion) in 2011 to 21.0 trillion Korean won (US\$18.5 billion) in 2015 (KOTEC, 2016).

Lending from Public Institutions

The SBC provides two types of loans, i.e. direct loans and indirect loans, to SMEs. Under its direct loan programme, it supplies long-term, i.e. 3 to 8 years, and low-interest lending to SMEs. For the indirect loan, the SBC provides funds to commercial banks and lets them choose firms to which they lend. It expects to enhance the efficiency of asset allocation by utilizing the knowledge and experience of financial institutions (Korea Development Institute (KDI) *et al.*, 2011: 8). In 2009, 46.3 percent of SBC's loans was of the direct loan type involving 2.2 trillion Korean won (US\$1.7 billion), while the remaining part was of indirect loans of as much as 2.6 trillion Korean won (US\$2.0 billion). In 2010, its budget for total loan support of SMEs reached 3.1 trillion Korean won (US\$2.7 billion) (Felipe, 2015: 257). The SBC provided policy loans as much

as 4.5 trillion Korean won (US\$3.9 billion) to SMEs in 2016 (SBC, 2017: 18). The Korea Finance Corporation (KoFC) also lends to SMEs based on a market-oriented approach called on-lending,² where it provides up to 40 percent of the amount of commercial banks' lending to SMEs. The commercial banks cover the remainder under their own responsibilities. Such risk-sharing may encourage commercial banks' lending to SMEs (KDI *et al.*, 2011: 8).

In 2009, the government introduced the Fast Track Programme, which requires commercial banks to evaluate SMEs on the basis of the guidelines set by the Financial Supervisory Service to determine whether the concerned SMEs should receive new loans or not. This simplified the loan application procedure for low-credit SMEs in Korea (Jung and Lim, 2016: 4, 40).

Lending by Commercial Financial Institutions Directed by the Bank of Korea

The Bank of Korea (BOK) as the monetary authority obliges commercial banks to support SMEs using two instruments: the mandatory minimum ratio of loan to SMEs and the Aggregate Credit Ceiling System (ACCS). The former, which was introduced in 1965, obliges all commercial banks to provide SMEs more than a specified proportion of their loans. The mandatory minimum ratio of bank loans to SMEs required from commercial banks rose from 30 percent during the 1960s and 1970s to 35 percent in 1980 and then to 45 percent in 1992. The percentage of the loan to SMEs required to the government-owned Industrial Bank of Korea has continued to be 90 percent since the 1960s. Commercial banks' loans to SMEs have considerably expanded since 1965 thanks to the mandatory minimum ratio of bank loans to SMEs, although as a result the financial credibility of the borrowing SMEs was often overlooked (United Nations *et al.*, 2002: 192). As a result of the economic crisis that occurred in 1998, commercial banks tried to reduce risk and, consequently, the share of their lending to individuals began to dominate that to companies (Kim and Mah, 2017).

In addition to the requirement of the minimum ratio of bank lending to SMEs, the BOK also maintains the ACCS, by which it provides funds to local commercial banks at low interest rates under conditions of supporting the operating capital of SMEs. The Aggregate Credit Ceiling Loan (AACL) aims at providing loans to commercial financial institutions within a ceiling set by the Monetary Policy Committee, based on their particular performance of lending to SMEs. Since 1995, the BOK has provided short-term funds not exceeding 8.5 trillion Korean won each year (about US\$7.5 billion in 2016) at an interest

rate lower than the market interest rate to financial institutions showing a satisfactory record of lending to SMEs (Yi, 2012). According to Jung and Lim (2016), ACCS helps increase bank loans to SMEs and reduces lending interest rates applied to them. They conclude that such effects are particularly prominent for enterprises with medium credit scores, start-ups, and enterprises newly eligible for the ACCS.

The BOK allocates funds to commercial banks after determining aggregate credit ceilings quarterly, based on the results of loans provided to SMEs by the banking institutions. The BOK applies interest rates that are lower than the market interest rates to its aggregate credit ceiling loans.³The positive effects of the ACCS have been to accelerate the commercial banks' selective financial support for SMEs, reduce the loan-related expenses of the SMEs with the application of preferential interest rates, thus increasing the commercial banks' lending to them (Jung and Lim, 2016: 8).

Investment in Venture Businesses

The government has invested in SMEs through the Korea Venture Investment Corporation (KVIC), which was established in 2004 by the SBC. The KVIC supports venture businesses through shareholding. Shareholding is more advantageous than loans, particularly for start-ups and venture businesses, which face high uncertainty and lack stable cash flows. Newly established firms, which need large funding for research and development (R&D) and equipment, are likely to prefer risk-sharing with investors rather than bearing the burden of interest payment. In addition, although debt as a result of lending has to be repaid by the borrower, only dividends are to be paid to the shareholders (KDI *et al.*, 2011: 9).

Tax Incentives

The Korean government has provided various kinds of tax incentives to promote SMEs. To encourage technological development, during the 1980s it provided tax incentives such as investment credit, additional depreciation, and reserves for technological development to assets related to new technologies. Moreover, for SMEs newly established in the technology-intensive industries, the government provided tax incentives including income or profit tax exemption for 4 years and 50 percent tax reduction for the following 2 years. In 1996, SMEs began to be granted tax relief for human resources and technologies. In 1997, for SMEs the way of collecting customs duties changed from prepayment

and post-compensation to post-payment to relieve the financial burden of SMEs (The Ministry of Strategy and Finance in Korea (MOSF), 2015).

After the occurrence of the economic crisis in 1998, the government strengthened tax incentives to promote SMEs further. In 2000, tax reform supported 16 types of local SMEs in retail, wholesale and construction by reducing income tax and profit tax rates by 30 percent. In 2002, the number of industries offered SME special tax exemptions expanded from 9 to 27. In 2003, the government reduced the profit tax rate, aiming at boosting SMEs, and offered more tax deductions to promote venture businesses. For instance, it extended the period of regarding an SME as a venture business to three years. In 2010, to encourage cooperation between *chaebols* and SMEs, it began to provide tax deduction to the firms involved in such cooperation. Compared to investment tax deductions for R&D investment in general, R&D related to new growth engines and advanced technologies began to enjoy larger tax deductions (MOSF, 2015). Although the government expanded tax incentives to promote R&D activities overall during the 2000s, tax incentives to large enterprises based on firm size shrank, while those provided to SMEs expanded (Kim, 2012: 247).

Tax reform was carried out again in 2013. Tax incentives for R&D expenditure in promising service sectors were expanded and tax credit began to be provided to R&D activities. To support SMEs, the burden of gift tax was reduced with regard to profits from transactions between a parent company and a subsidiary, while those inheriting family businesses could enjoy deduction for inheritance tax purposes. To induce further investment in start-ups, tax benefits for angel investors were expanded.⁴ Furthermore, tax credits for investments associated with job creation were expanded in relation to part-time workers, and tax benefits increased to support SMEs hiring more employees. In 2015, various kinds of reforms took place in tax policy. SMEs offering more jobs to young workers began to be provided more tax incentives. Moreover, to lessen the burden of exporting enterprises, a scheme of deferment of value-added tax payment with respect to imported goods was introduced to exporting SMEs and tax incentives were expanded to facilitate venture businesses and angel investments (MOSF, 2015 and 2016).

Human Resources and Indirect Support

Human Resources

Unlike large companies, SMEs are likely to face difficulties in recruiting and retaining talented employees. The Korean government's recognition of the

importance of human resources in the business activities of SMEs was expressed in the Special Act on Support for Human Resources in SMEs, legislated in 2003. The Act targeted contributing to the balanced development of the national economy by strengthening the competitiveness of SMEs and promoting the employment thereof, and upgrading SME human resources (SMBA, 2017). Since then, in particular, the government has actively tried to support strengthening the base of human resources of SMEs.

During the first half of the 2010s, the human resources policy has focused mainly on supporting the SMEs attracting and training human resources, particularly in R&D-related activities. The government programmes supporting SMEs' R&D-related human resources can be classified into one of the following aspects. First, high school and college students specializing in design are able to participate in SMEs. Second, the government provides SMEs partial support for the labour costs of experienced technicians as well as those holding a master's degree in either natural science or engineering. Third, it supports SMEs' employment of foreign engineers in domestic R&D-related centres. There is an additional support in which SMEs can utilize researchers affiliated with the government research institutes for more than three years. Fourth, it supports the strengthening of vocational abilities of workers employed in SMEs. Fifth, the government provides opportunities for training students in SMEs with the goal of employment in those same SMEs after graduation (Yang and Choi, 2013: 2-3).

The SBC, established in 1979, has maintained the programme called 'Support of SMEs' Human Resources', which supports human resources in SMEs. The amount allocated by the SBC to implement this increased from 15.8 billion Korean won (US\$13.7 billion) in 2010 to 25.5 billion Korean won (US\$24.2 billion) in 2014. Support of training programmes shares about 80 percent of the budget (Mah, 2016). Since the early 2000s, it has operated five training institutes with dormitories to train SME employees with respect to production and management techniques. In 2016, it trained as many as 48,282 trainees. The total number of workers trained in the SBC training institutes reached 1,380,000 by the end of 2016 (SBC, 2017).

Demands for human resources having advanced technologies and skills are high in the companies producing technology-intensive products. The Korean government has collaborated with the private companies to strengthen the SMEs' capabilities by providing appropriate human resources. For instance, at Gumi Industrial Complex, which is the largest national industrial complex in Korea

accommodating firms mostly in the electricity and electronics industry, firms, universities and the Korea Industrial Complex Corporation (KICOX) are cooperating to establish the human resources plan customized for firms. The government-run KICOX finances the programme (KICOX, 2015: 105).

Since the Korean economy has heavily relied on exports, the government has actively tried to promote exports of SMEs. In order to strengthen human resources in international trade, the Korea International Trade Association (KITA) maintains trade practice training programmes and Cyber Trade Campus educating trade practices via online sites. The government-run Korea Trade and Investment Promotion Agency (KOTRA) trains the foreign market experts and maintains the training programmes run by industries, where most training costs are supported by this agency. The beneficiaries of such training programmes are in practice SMEs (The Ministry of Trade, Industry and Energy (MOTIE), 2017).

Indirect Support

With the fall of the Washington Consensus, which pursued the market mechanism to the fullest extent, industrial policy has been experiencing a renaissance. The new industrial policy approach abandons the command-and-control mechanisms of the past. Instead, it recognizes the allocative efficiency of competitive market prices and prioritizes government assistance, multi-sectoral dialogue and joint state-business problem-solving (Fuentes and Pipkin, 2016: 175). As a part of the new industrial policy, the Korean government has tried to provide indirect support measures to SMEs.

Among others, various trade-related organizations in Korea are involved in providing indirect support measures to promote Korea's exports. Such measures comprise: supporting SMEs' access to foreign networks, supporting e-commerce, and ways of further utilization of Free Trade Areas. For instance, KOTRA and KITA provide trade information to SMEs. They support trade fairs and trade expos abroad. KITA maintains a trade-related statistics portal service and provides trade-related information abroad, including tariff rates, regulations, certificates, non-tariff barriers and support measures. Those two trade-supporting organizations provide detailed information on international trade. Most of the beneficiaries are SMEs that do not have their own capabilities of collecting and processing the necessary trade information (MOTIE, 2017).

The Korea Commission for Corporate Partnership (KCCP) tries to network large companies including *chaebols* with SMEs. It computes and announces a

corporate partnership index by regularly quantifying the level of each *chaebol's* corporate partnership with SMEs. In addition, it designates and announces business areas suitable for SMEs. When the SMEs are going through financial difficulties due to *chaebol's* indiscriminate expansion, it shows the roles of *chaebols* and those of SMEs. It also holds various events relevant to corporate partnership to raise social awareness and disseminate the culture of corporate partnership (KCCP, 2017).

Policy Implications for Developing Countries

The transition from *chaebols*-led to SMEs-centred economic development started in the early 1980s. Thus, the contribution of *chaebols* in the process of rapid economic growth of Korea seems to have been overemphasized since the 1980s. Korea's experience of economic development indicates that heavy dependence on large enterprises may create a serious structural problem in the long run, as was witnessed in the occurrence of the economic crisis in Korea in the late 1990s (Mah, 2006). The Korean government began to introduce SME-supporting policy measures in 1981. In general, the share of SMEs in the Korean economy started to increase during the 1980s. Meanwhile, the SME promotion policy may have led to inefficient use of funds in the sense that such a support measure may have caused inefficient SMEs to survive.

The Korean government has tried to support SMEs, particularly those with advanced technologies. This is appropriate in light of the important role of high-tech in the Korean economy. Thus, the SME promotion policy needs to be accompanied by the promotion of the technology level of the economy concerned in the sense that improvement in technology and productivity leads to long-term economic growth.

Credit guarantees and policy loans at preferential lending interest rates have been actively provided by the government. They aim at relieving the financial difficulties of, among others, SMEs lacking collateral. Since SMEs in most developing countries also suffer from a lack of collateral, developing countries may refer to such financial incentives provided in Korea. In addition, since 2004 the Korean government has promoted SMEs through shareholding. This is an attractive way of supporting them in the sense that the borrowing investors can reduce interest payment to the lenders. Therefore, it would be necessary for developing countries to prepare funds and maintain organizations devoted to such programmes.

In addition to financial incentives, the Korean government has provided various kinds of tax incentives to promote SMEs. Such tax incentives were strengthened in the process of promoting SMEs further after the economic crisis in 1998. Most of them have been related to R&D activities and technological development, while more recently applied tax incentives aim at supporting SMEs generating job opportunities to youth due to the issue of rising youth unemployment. The benefits and costs of such tax incentives need to be considered. That is, the benefits including technological development and boosting innovation as well as generating job opportunities need to be compared with the tax revenue lost. One cannot derive a definitive conclusion from such a comparison in the sense that the effectiveness of tax incentives in generating technological development and job opportunities may differ depending on the country concerned, and the fiscal situation of the government differs significantly across developing countries.

Realizing the difficulties of SMEs in recruiting and training human resources, the Korean government has maintained programmes supporting the improvement of human resources employed in SMEs. According to a survey conducted in 2013 with respect to 12,064 companies, which carried out R&D projects supported by the Korean government for over 3 years. Respondents answered that tax incentives and programmes supporting human resources are the most effective of all the government's policy measures. Some 41.6 per cent of the respondents answered that support for human resources was significantly meaningful and 51.8 per cent of them said it was quite helpful (Yang and Choi, 2013: 3). This implies that about 93 per cent of the responding firms found the government's human resource-enhancement programmes to be beneficial to firms' businesses. Thus, in light of the experience of Korea's SME promotion policy, it is necessary for developing countries to acknowledge the importance of improving human resources in SMEs and to prepare programmes aimed at this.

In addition, as is emphasized in the new industrial policy, it is necessary for the governments of developing countries to enhance indirect support, such as the provision of infrastructure, information and networking between large companies and SMEs. This has become more important in the World Trade Organization system, which strictly regulates direct support including tax and financial incentives.

Conclusion

Korea has grown from being one of the poorest agrarian countries in the world in the 1950s to one of the industrialized economies. Economic development

during the rapid growth period was widely known to have been driven by the large conglomerates called *chaebols*. For the purpose of pursuing the export-led economic growth focusing on the HCIs, the Korean government actually supported the development of *chaebols*. During the 1970s, SMEs played only a supplementary role in the economic development. Despite rapid economic growth, structural problems such as the imbalance between *chaebols* and SMEs increased. The Korean government realized the importance of promoting SMEs. Its concern about promoting them was reflected by the SMEs Promotion Act, which was legislated in 1978.

The Korean government began to take concrete SME promotion measures from the 1980s. Consequently, the proportion of SMEs in the Korean economy increased from that time. Observing a series of failures of *chaebols* during the period of economic crisis, the government strengthened SMEs and venture businesses promotion measures in the late 1990s and early-to mid-2000s. The government's current SME promotion measures comprise the traditional industrial policy instruments, such as financial and tax incentives, as well as measures enhancing human resources and the new industrial policy measures, which include the provision of infrastructure, information to SMEs, and networking large companies with SMEs.

As a result of the government's active SME promotion policy, SMEs are constantly growing in size and influence. Korea's experience of transition from a *chaebols*-led to SMEs-centred economic development strategy provides important policy implications to developing countries that try to achieve both rapid economic growth and structural development. Among others, Korea's experience of economic development indicates that heavy dependence on large enterprises may create a serious structural problem in the long run, as was observed in the occurrence of the economic crisis in Korea in the late 1990s. The Korean government has tried to support SMEs, particularly those with advanced technologies. Thus, an SME promotion policy needs to be accompanied by the promotion of the technology level of the economy.

Korea's experience shows the government's human resource-enhancement programmes to be most helpful to the business activities of SMEs. Credit guarantees to SMEs lacking collateral, and policy loans at preferential lending interest rates have been actively provided by the government. Since SMEs in most developing countries suffer from a lack of collateral, developing countries may refer to such financial incentives provided in Korea. In addition, the Korean government has promoted SMEs through shareholding since 2004. This is an

attractive way of supporting them in the sense that the borrowing investors can reduce interest payment to the lenders. In addition to financial incentives, the Korean government has provided various kinds of tax incentives to promote SMEs, although the benefits and costs of such tax incentives need to be considered. That is, the benefits including technological development and generating job opportunities are to be compared with the tax revenue lost. In addition to the direct measures supporting SMEs, it is necessary for the governments of developing countries to enhance indirect support, such as the provision of infrastructure, information and networking between large companies and SMEs.

Notes

1. The *chaebols* are vertically integrated and highly diversified large conglomerates sharing personal, operational, and financial ties among subsidiaries within the centralized group structure controlled by the owner and his/her family (Lim, 2002: 16).
2. On-lending is a policy loan scheme where the government allocates capital to commercial banks, and commercial banks engage in screening, executing and monitoring loans to SMEs (Kim, 2010).
3. In July 2007, the aggregate credit ceiling support provided by the BOK equalled 6.5 trillion Korean won (US\$7.0 billion), but in response to the global financial crisis, it increased the ceiling sharply to 10 trillion Korean won (US\$7.8 billion) by March 2009. The applied interest rate was lowered from 3.5 per cent per year to 1.75 per cent in December 2008, and to 1.25 per cent in February 2009 (Jung and Lim, 2016: 8).
4. Angel investors are individuals or groups of individuals who invest in early stage venture businesses (Korea Business Angels Association, 2017).

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