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SMALL AND MEDIUM ENTERPRISES (SMEs) DEVELOPMENT
SMALL AND MEDIUM ENTERPRISES (SMEs) POLICY APPROACHES:
IN THE REPUBLIC OF KOREA*

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* The views expressed in this paper are those of the author and do not necessarily reflect the views of the Secretariat of UNIDO. This document has not been edited.

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- CONTENTS -

I. INTRODUCTION	1
II. DEFINITION OF SMEs	2
III. GROWTH AND STRUCTURAL CHANGE OF SMEs	4
IV. OVERVIEW OF DEVELOPMENT POLICY AND IMPACT ON SMEs ..	11
V. MAJOR POLICY MEASURES FOR PROMOTING SMEs	17
VI. PROBLEMS FACING SMEs	31
VII. CHARACTERISTICS OF KOREA'S SMEs DEVELOPMENT POLICY AND IMPLICATIONS	37
VIII. CONCLUDING REMARKS	41

- <Table 1 > Legal Definition of SME in Korea**
- <Table 2 > Exceptional Industries among SMEs-Definition in Korea**
- <Table 3 > Additional Asset Criteria for SMEs in Korea**
- <Table 4 > SMEs and LSEs in Manufacturing**
- <Table 5 > Proportion of SMEs in the Manufacturing Industry
in Korea, Japan and Taiwan (1990)**
- <Table 6 > Exports by SMEs in 1980s**
- <Table 7 > SMEs and LSEs in the Light and Heavy and Chemical
Industries**
- <Table 8 > Structural Change in Manufacturing by Industry**
- <Table 9 > Number of Firms, Employment and Value Added by
Size of Workers**
- <Table 10> Technology Imports by Size of Firms(1962-1991)**
- <Table 11> Shortage Ratios of Production Workers in
Manufacturing**
- <Table 12> Turnover Rate of Production Workers in SMEs**
- <Table 13> Labor Productivity of SMEs Compared with LSEs**
- <Table 14> Capital/Labor Ratio in Manufacturing**
- <Table 15> The Annual R&D Expenditure of SMEs in
Manufacturing Industries**
- <Table 16> Debt/Equity Ratio of SMEs**

I. INTRODUCTION

The Korean economy registered remarkable economic growth for the last three decades. GNP grew 8.8 percent per annum between 1962 and 1991. This growth was largely due to the rapid expansion of manufacturing industry, with its annual growth rate of 15.1 percent during this period. The manufacturing sector was the engine of growth driven by the outward-looking, government-led development strategy which the Korean government has pursued since early 1960s.

The Korean model of industrialization has been often described as "large-scale enterprise-oriented development" since the large-scale enterprises have played a key role in Korea's rapid industrial development. Being a latecomer with few natural resources, Korea started its industrialization process by making good use of abundant cheap labor, thereby compensating for the lack of natural resources and shortage of capital. Since economic growth was of utmost concern of the government, the development policy focused on economic growth through processing and assembly of imported raw materials and intermediate goods in large volume. As a result, the large-scale firms grew faster with a corresponding increase in the concentration of economic power in the hands of big conglomerates, the so called "Chaebol".

Because of this development strategy the small and medium scale enterprises (hereinafter called SMEs) suffered a considerable setback in the 1960s and 1970s. The decline of SMEs, however, emerged as a major structural problem, hindering continued expansion of the Korean Economy in late 1970s. Thus, the

government made serious efforts to promote SMEs through various support programs and incentives beginning in early 1980s. Thanks to governmental support measures, SMEs began to recover their growth momentum and made a significant progress in the 1980s.

The purpose of this paper is to review how the changing development strategy affected the growth and structural changes of SMEs, and to explain what kind of policy measures were undertaken to promote SMEs as the development strategy changed in response to changing economic environments, and finally, to highlight the major characteristics of Korea's SMEs development policy in order to derive some implications from the Korean experiences.

II. DEFINITION OF SMEs

The legal definition of SME in Korea is found in the SME Basic Act, as shown in table 1. One of the primary criteria for defining SME is the number of full-time employees. Basically, those enterprises in manufacturing, mining and transportation which have 20 full-time employees or less are defined as small-sized, while those with less than 300 but more than 20 full-time employees are defined as medium-sized. In construction, the small enterprises are defined in the same manner as in manufacturing; medium-size enterprises, however, may only have up to 200 full-time employees. In the trade and other services sector, small and medium enterprises may have 5 and 20 employees, respectively.

< Table 1 > Legal Definition of SME in Korea

Industry	Small Enterprise	Medium Enterprise
Manufacturing Mining Transportation	20 Employees or Less	Between 21 and 300 Employees
Construction	20 Employees or Less	Between 21 and 300 Employees
Trade (Retail and Wholesale) and other Services	5 Employees or Less	Between 21 and 300 Employees

The Enforcement Decree of the SME Basic Act further establishes different criteria for certain industries, as shown in table 2.

< Table 2 > Exceptional Industries among SMEs-Definition in Korea

Industries	Criteria
Coal Mining and China and Earthenware Manufacturing	700 Employees or Less
Textiles, Plastic Footwear Manufacturing, and Auto Parts Manufacturing	500 Employees or Less

According to the Enforcement Decree of the SME Basic Act, SMEs in certain industries are also defined by total assets. Consequently, SMEs must meet both the employee and asset criteria to benefit from SMEs promotion policies and measures.

< Table 3 > Additional Asset Criteria for SMEs in Korea

Industry	Asset Criteria
Mining, Textiles, Other Manufacturing	4 Billion Won (\$ 5 Mil.) or Less
Food and Tobacco, Wood, Non- Metallic, etc.	6 Billion Won (\$ 7.5 Mil.) or Less
Paper and Printing, Chemicals, Fabricated Metals, Basic Metals, etc.	8 Billion Won (\$ 10 Mil.) or Less

III. GROWTH AND STRUCTURAL CHANGE OF SMEs

For the last three decades, the manufacturing sector in Korea has experienced considerable structural transformation, characterized by the increasing importance of heavy and chemical industry and large-scale firms in output, employment and number of firms.

As the structure of production became capital-intensive, the size of firms grew, resulting in the increasing importance of large-scale firms in the manufacturing industry. The share of large-scale firms in value added and employment in the manufacturing sector increased from 47.2% and 33.6% in 1963 to 55.7% and 38.3% in 1990, respectively. Even in terms of number of establishments, share of large-scale firms increased from 1.3% to 1.7% in 1990. (See Table 4)

The increasing role of large-scale firms in manufacturing sector is an important feature of Korea's industrialization process, which resulted in the relative decline of SMEs during this period. The relatively weak position of SMEs in manufacturing is more noticeable when we compare it with other countries such as Japan and Taiwan. In 1990, the proportion of the SMEs to total number of firms was 98.3%, 98.3%, 99.1% in Korea, Taiwan and Japan, respectively, but the proportion of employment accounted for by SMEs was 61.7%, 70.4% and 72.4%, respectively. The weakness of SMEs in Korea is more pronounced when we look at producer's shipments. (see table 5)

It is true that SMEs in manufacturing sector in Korea did not grow as fast as large-scale firms over the last three decades. This does not, however, imply that SMEs made no significant progress during this period. In fact, SMEs have made considerable progress. The number of SMEs increased 3.7 times between 1963 and 1990. Employment increased almost 7 times during this period.

<Table 4> SMEs¹⁾ and LSEs²⁾ in Manufacturing

	1963 (A)	1973 (B)	1980 (C)	1990 (D)	B/A	D/C	D/A
No. of Establishments:	237	1,037	1,044	1,193	4.38	1.14	5.03
LSEs	(1.3)	(4.5)	(3.4)	(1.7)			
SMEs	18,073	22,256	29,779	67,679	1.23	2.27	3.74
	(98.7)	(95.5)	(96.6)	(98.3)			
Total	18,310	23,293	30,823	68,872	1.27	2.23	3.76
	(100.0)	(100.0)	(100.0)	(100.0)			
No. of Workers (in thousands) :	135	701	1,015	1,156	5.19	1.14	8.56
LSEs	(33.6)	(60.6)	(50.4)	(38.3)			
SMEs	267	457	1,000	1,864	1.71	1.86	6.98
	(86.4)	(39.4)	(49.6)	(61.7)			
Total	402	1,158	2,015	3,020	2.88	1.50	7.51
	(100.0)	(100.0)	(100.0)	(100.0)			
Value added (percentages) :							
LSEs	47.2	72.8	64.8	55.7	-	-	-
SMEs	52.8	27.2	35.2	44.3	-	-	-
Total	100.0	100.0	100.0	100.0	-	-	-

Source : Major Statistics of Small and Medium Industries, various years, Small and Medium Industry Promotion Corporation (SMIPC).

Note : 1) Enterprises with 200 employees or less are defined as SMEs until 1973.

2) Denotes large-scale enterprises.

Figures in parenthesis are percentages.

<Table 5> Proportion of SMEs in the Manufacturing Industry in Korea, Japan and Taiwan (1990)

(Unit : %)

	Korea	Japan	Taiwan ¹⁾
Number of Firms	98.3	99.1	98.3
Employment	61.7	72.4	70.4
Shipments	42.6	51.8	49.6

Source: Korea Institute for Industrial Economics and Trade.
 Note : 1) 1985 figures except for number of firms.

More importantly, the declining importance of SMEs in manufacturing industry reversed since 1980. In other words, SMEs in manufacturing recovered lost ground and grew faster than large-scale firms since 1980. The number of SMEs more than doubled, and employment also almost doubled between 1980 and 1990, while large-scale firms didn't improve much in terms of both number of firms and employment. The value added share of SMEs jumped from 35.2% in 1980 to 44.3% in 1990. The SMEs contribution to total exports increased from 22.1% in 1982 to 42.1% in 1990. (see table 6)

< Table 6 > Exports by SMEs in 1980s

(Unit : million \$)

	Total	SMEs	Weight of SMEs
1982	21,853	4,823	22.1
83	24,445	4,894	20.0
84	29,245	7,443	25.4
85	30,283	8,414	27.8
86	34,714	12,230	35.2
87	47,281	17,812	37.7
88	60,696	23,152	38.1
89	62,337	26,046	41.8
90	65,016	29,581	42.1

Source : Ministry of Trade and Industry.

The reversing trends of SMEs since 1980 are found not only in light industry but also in heavy and chemical industry (see Table 7). The share of SMEs in the light industries increased considerably in employment, value added as well as in number of firms.

<Table 7> SMEs and LSEs in the Light and Heavy and Chemical Industries

(Unit : %)

	Number of Firms				Employment				Value Added			
	1970	1975	1980	1990	1970	1975	1980	1990	1970	1975	1980	1990
Light Ind.												
SMEs	97.2	96.2	97.0	98.4	47.9	44.7	51.0	66.9	29.4	31.7	36.4	54.2
LSEs	2.8	3.8	3.0	1.6	52.1	55.3	49.0	33.1	70.6	68.3	63.6	45.8
H&C Ind.												
SMEs	96.8	96.1	96.1	98.1	50.9	47.4	49.6	57.4	27.9	31.6	34.0	39.3
LSEs	3.2	3.9	3.9	1.9	49.1	52.6	50.4	42.6	72.1	68.4	66.0	60.7
Total Manu.												
SMEs	97.1	96.2	96.6	98.3	49.0	45.7	49.6	61.7	28.8	31.7	35.2	44.3
LSEs	2.9	3.8	3.4	1.7	51.0	54.3	50.4	38.3	71.2	68.3	64.8	55.7
Total SMEs.												
LI	66.6	64.3	59.3	49.7	63.0	61.9	57.9	49.5	57.9	54.2	49.2	41.5
HCI	33.4	35.7	40.7	50.3	37.0	38.1	42.1	50.5	42.1	45.8	50.8	58.5

Source : Report on Mining and Manufacturing Survey, Various years, Economic Planning Board.

Even if we look at SMEs at 2 digit industry level, we find that increasing role of SMEs in the 1980s are found in almost all industries(see table 8). Particularly notable is the fact that SMEs in labor intensive light industries such as food and beverages, textiles, apparel and leather, and wood and wood products gained considerably in terms of value added and employment. This is largely due to the eroding competitiveness of large scale firms in these industries.

<Table 8> Structural Change in Manufacturing by Industry

	1980			1990		
	No. of Firms each(%)	Employment person(%)	Value Added bill. won(%)	No. of Firms each(%)	Employment person(%)	Value Added bill. won(%)
Food and Beverages						
SMES	4,529(96.1)	103,895(57.3)	549.4(27.9)	4,599(97.5)	136,910(63.9)	2,926.9(30.5)
LSES	8(1.9)	77,439(42.7)	1,418.8(72.1)	119(2.5)	77,314(36.1)	4,687.3(61.5)
Textiles excluding Leather						
SMES	6,741(95.8)	294,976(50.9)	848.6(39.3)	14,055(98.5)	423,992(71.2)	4,746.2(63.5)
LSES	293(4.2)	284,182(49.1)	1,310.9(60.7)	207(1.5)	171,108(29.8)	2,496.4(32.5)
Leather Including Footwear						
SMES	618(95.4)	23,712(54.8)	79.3(32.3)	1,978(96.8)	97,883(81.7)	968.5(79.7)
LSES	20(4.6)	19,274(45.2)	72.4(47.7)	23(1.2)	12,970(18.3)	281.5(21.2)
Wood Prod.						
SMES	2,172(98.7)	34,590(52.6)	120.3(47.9)	3,864(99.3)	64,379(74.0)	869.3(66.5)
LSES	28(1.3)	31,184(47.4)	82.6(27.1)	27(0.7)	22,987(26.9)	438.5(33.5)
Paper Prod.						
SMES	2,253(98.0)	60,930(67.3)	270.9(51.5)	4,879(99.0)	102,468(76.4)	1,926.3(56.5)
LSES	47(2.0)	29,612(32.7)	259.6(88.5)	54(1.0)	31,991(23.6)	1,287.0(41.5)
Rubber						
SMES	314(89.0)	11,190(10.7)	36.9(9.3)	1,583(94.0)	65,837(35.9)	708.0(32.7)
LSES	39(11.0)	93,181(89.3)	362.0(90.7)	101(6.0)	117,620(64.1)	1,456.0(67.3)
Other Manufacturing						
SMES	1,025(97.2)	49,863(70.7)	147.0(6.0)	2,733(99.1)	70,645(75.1)	902.5(72.1)
LSES	29(2.8)	20,662(29.3)	79.8(32.0)	24(0.9)	23,286(24.9)	349.8(27.9)
Total Light Industry						
SMES	18,206	1,134,960	5,663.7	34,200	1,379,344	24,887.9
LSES	17,652(97.0)	979,166(91.0)	2,052.6(36.4)	32,649(96.4)	925,520(66.9)	13,047.7(54.2)
	554(3.0)	559,814(49.0)	3,581.1(73.6)	551(1.6)	456,828(33.1)	31,040.2(49.8)

Chemicals, Petroleum, Coal and Plastic Prod. SMEs LSEs	2,588(96.5) 93(3.5)	95,146(59.1) 65,741(40.9)	767.8(37.8) 1,260.8(62.2)	6,035(98.3) 105(1.7)	171,999(88.6) 70,796(31.4)	4,645.7(43.1) 6,128.9(56.9)
Non-Metallic Mineral Prod. SMEs LSEs	2,348(97.7) 56(2.3)	58,646(61.9) 36,975(38.1)	312.8(45.8) 369.8(54.2)	3,603(98.5) 55(1.5)	94,443(73.7) 33,627(26.3)	2,201.6(62.7) 1,311.2(37.3)
Basic Metals SMEs LSEs	824(94.5) 48(5.5)	34,204(38.1) 55,672(61.9)	180.4(19.5) 743.7(80.5)	1,420(96.5) 58(3.5)	58,443(46.3) 69,464(53.7)	1,346.5(25.8) 3,892.1(74.2)
Fabricated Metal Prod. SMEs LSEs	6,367(95.6) 293(4.4)	233,002(43.4) 301,303(56.6)	854.7(24.8) 1,733.0(75.2)	22,772(98.2) 424(1.8)	618,784(54.3) 320,936(45.7)	10,190.7(37.3) 17,129.5(62.7)
Total Heavy and Chemical Industry SMEs LSEs	12,617 13,127(98.1) 490(3.9)	879,791 420,898(47.8) 458,893(52.2)	6,223.0 2,118.7(34.0) 4,107.3(66.0)	34,672 34,030(98.1) 642(1.9)	1,640,472 941,869(57.4) 698,603(42.6)	46,863.0 18,384.5(39.2) 28,478.1(60.7)

Source : Report on Mine and Manufacturing Survey, Various years.
Economic Planning Board.

The large-scale production based on cheap labor was no longer sustainable due to rapid rise in wages. A number of large firms went bankrupt and others had to reduce their production lines, or subcontract. As a result, absolute number of workers employed at large-scale firms in textiles and leather products considerably decreased between 1980 and 1990. A particularly large reduction was observed in footwear and leather products which relied heavily on export market. This implies that some structural adjustment took place in labor intensive light industries, reflecting changing Korea's comparative advantages.

As far as heavy and chemical industries are concerned, no such structural adjustment was observed as in labor intensive light industries. All industries at 2 digit level gained in terms of employment and value added, and even in terms of number of firms. The fabricated metal products, machinery and equipment, however, gained the most in this structural transformation process of 1980s.

When we look at the structural change within the SMEs sector, however, we find a considerable change in favor of heavy and chemical industries. Traditionally, SMEs had comparative advantages in the labor intensive industries which were export-oriented. But the labor intensive industries lost gradually their comparative advantage as the export incentive were drastically reduced while wages increased rapidly. As a result, the relative position of labor intensive light SMEs within the SMEs sector declined continuously since early 1970s. For instance, the share of the light SMEs in terms of value added

in total SMEs sector decreased from 57.9 percent in 1970 to 41.5 percent in 1990, whereas the share of heavy and chemical SMEs increased from 42.1 percent to 58.5 percent in the same period. (see table 7). The increasing importance of heavy and chemical SMEs within the SMEs sector is due to the rapid expansion of electronics, shipbuilding and automotive industry in which SMEs played an important role as supplier of parts and components. This suggests that a considerable structural upgrading has been made even within the SMEs sector.

Looking at structural changes in SMEs by size of firm, we find that small firms with less than 50 workers gained the most in terms of number of establishments, employment and output during 1980s (see table 9). This seems to suggest that many small business start-ups took place in the manufacturing industry in this period. The various support programs and incentives which were greatly strengthened in 1980s had undoubtedly made great contribution to this rapid growth of small firms.

<Table 9> Number of Firms, Employment and Value Added by Size of Workers

(unit : %)

	No. of Firms			Employment			Value Added		
	1980	1985	1990	1980	1985	1990	1980	1985	1990
5-19	58.0	58.0	60.7	8.2	10.3	14.0	4.0	4.5	7.0
20-49	21.0	23.0	24.8	10.1	13.1	17.4	5.7	7.2	10.6
50-99	9.5	9.7	8.1	10.3	12.3	12.5	7.3	8.2	9.6
100-299	8.1	6.8	4.7	21.0	20.4	17.7	18.2	17.6	17.1
300 and more	3.4	2.5	1.7	50.4	43.9	38.3	54.8	62.4	55.7
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : Report on Mining and Manufacturing Survey, various years, Economic Planning Board.

IV. OVERVIEW OF DEVELOPMENT POLICY AND IMPACT ON SMEs

The growth pattern of SME and its structural change in Korea were greatly affected by the government policies during the past three decades. There are two types of government policies affecting development of SMEs. One is the overall development strategy, which sets the basic framework within which individual policies are formulated. It decides overall policy directions setting priorities, etc. which indirectly affect the development of SMEs. The other type of government policy is specific policy measures directly related to the SMEs. It may be useful to have an overview of evolution of Korea's industrial development strategy before specific, detailed policy measures are reviewed.

Industrial development policy over the past three decades in Korea can be, broadly speaking, divided into three distinct phases of evolution, namely export-drive policy in 1960s, promotion of heavy and chemical industry in 1970s, and technology-oriented industrial policy in 1980s. The export-drive policy and policy of heavy and chemical industry promotion worked in favor of large scale-firms and discriminated against SMEs. The both strategies were characterized by excessively subsidized credit.

The export drive policy relying heavily on liberal financing at preferential interest rate greatly benefitted large-scale firms for the following reasons; first, large scale firms had better access to financial institutions than SMEs which lack collateral and credit worthiness. Second, it facilitated large scale assembly production by permitting duty-free import of raw

materials and equipment. Third, it discriminated against domestic market-oriented industries which did not receive incentives and consisted mostly of SMEs.

The promotion of heavy and chemical industry in the 1970s largely centered on such capital intensive large-scale industries as steel, shipbuilding, electronics, and machinery. The excessive subsidies on the import of raw materials, intermediate goods, and capital equipment led to discourage the backward linkages preventing development of supplier industries. The massive inflow of foreign capital since the early 1970s also contributed to shifting the structure of manufacturing industry toward large-scale firms, since foreign loans were mostly tied to big projects which could be carried out only by large-scale firms.

There were, of course, governmental efforts to promote SMEs during sixties and seventies. In the sixties, efforts were made to encourage SMEs in export activities. In 1964, for example, the government initiated a program to convert suitable SMEs into export industry by providing preferential facility loans and foreign exchange allocations, etc. In the same year, the Export Industrial Estate Development Act was created to support SMEs aiming at producing exportable items. The first export industrial estate was created in Kurodong located in the Seoul Metropolitan area in 1967, followed by two more estates, one in Bupyeong and the other in Chuan near Seoul. The Small and Medium Industry Bank was set up in 1961 to help financing problems of SMEs. The commercial banks were encouraged to extend more than 30% of total loans to SMEs.

In the seventies, the government became increasingly aware

of the importance of SMEs because the promotion of heavy and chemical industries needed well developed supplier industries. In order to promote parts and component industries, the government enacted the Small and Medium Enterprises Sub-contracting Promotion Act in 1975. In 1976, The Korea Credit Guarantee Fund (KCGF) was established to help financially weak SMEs. The Small and Medium Industry Promotion Corporation (SMIPC), a semi governmental organization, was set up to promote SMEs by providing various programs such as financial aid, management and information services, extension and training services, etc.

The promotional measures for SMEs in the sixties and seventies have been largely of a legal and institutional nature laying the basis for the growth of SMEs. But these couldn't immediately bear fruits. There were some monetary and fiscal incentives which were rather fragmentary and very selective. They were, however, not very effective in stimulating the growth of SMEs because the overall incentives scheme was overwhelmingly dominated by the excessive support for exports in the sixties and heavy and chemical industries in the seventies. Consequently, the SMEs suffered a considerable setback during this period while large scale firms grew very fast with a corresponding increase of industrial concentration in large scale firms.

Although the industrial development strategy in the 1960s and 1970s has been successful in terms of rapid growth and promotion of heavy and chemical industries, it generated a number of structural problems, such as a high rate of inflation, structural imbalance within the manufacturing sector, balance of payments difficulties, and deterioration of income distribution.

To cope with these structural problems, the government began to reshape the development policy by introducing wide-ranging macro economic as well as industrial policy reforms beginning in the early 1980s.

The basic philosophy was that the Korean economy should rely more on market mechanism and competition while reducing government intervention and support. The government began to overhaul the industrial incentive system, gradually replacing industry-specific support with functional support. Various incentives for exports and heavy and chemical industry were drastically reduced while increasing support was given to technology and manpower development. The multi-year import liberalization program was implemented in 1983, aiming at 95 percent of liberalization ratio by 1988. Along with import liberalization, tariff reform was carried out in 1984 to reduce protection for domestic industries. Foreign investment was also greatly liberalized by adopting a negative system. Technology licensing was greatly facilitated by changing to report system from an approval system.

Contrasting with the overall policy direction geared to reduce governmental support and intervention, the government policy toward SMEs was rather strengthened and intensified. The Korean government firmly believed that market economy in Korea could not prosper unless SMEs were fully developed and became competitive. Therefore, the government has made intensive and integrated efforts to promote SMEs.

In April 1982 a long-term plan was established for the promotion of small and medium industries extending up to 1991. The SME-related laws such as the SME Basic Act, SME promotion Act, etc. were amended to help achieve the long-term development

goals. A number of new promotional measures were taken, and existing ones were strengthened. Important among these measures are: start-up support program; support for promising SMEs; support for new technology-based firms ; support for managerial guidance and training services; reservation of areas for SMEs; establishment of rural industrial estate; structural adjustment program; strengthened financial and fiscal incentives, etc.

There is no doubt that these specific policy measures have certainly made a great contribution to the rapid growth of SMEs in the 1980s. It should be, however, emphasized that the overall economic policy direction placing great emphasis on liberalization, technology, and manpower development was also very conducive for the SMEs development.

<Table 10> Technology Imports by Size of Firms(1962-1991)
(unit : case)

	Large Firms	Small and Medium Firms	Others	Total
1962-1966	26 (78.8)	7 (21.2)	-	33 (100.0)
1967-1971	178 (62.5)	107 (37.5)	-	285 (100.0)
1972-1976	293 (67.5)	141 (32.5)	-	434 (100.0)
1977-1981	796 (65.0)	425 (34.7)	4 (0.3)	1,225 (100.0)
1982-1986	1,042 (50.1)	1,030 (49.6)	6 (0.3)	2,078 (100.0)
1987-1991	1,837 (52.9)	1,621 (46.7)	13 (0.4)	3,471 (100.0)
Total 1962-1991	4,172 (55.4)	3,331 (44.3)	23 (0.3)	7,526 (100.0)

Source : Ministry of Science and Technology.

Note : Figures in parentheses are percentages.

The industrial incentives system based on functional support benefitted SMEs because the new system was not disadvantageous for SMEs. Liberalization policy greatly helped SMEs by

facilitating the inflow of foreign capital as well as technology licensing for SMEs. As shown in table 10, the technology import of SMEs accounted for almost half of the total technology imports in the 1980s. Import liberalization compelled many SMEs to increase their productivity, to be more innovation-oriented, and to facilitate structural adjustment, thereby contributing to enhancing competitiveness of SMEs.

V. MAJOR POLICY MEASURES FOR PROMOTING SMEs

There are a variety of supporting programs and incentives for SMEs in Korea ranging from start-up assistance to internationalization of SMEs. The various policy measures for SMEs can be classified as follows:

- i) Encouraging Start-up and Stabilization of Business Operation
- ii) Support Through Financial Institutions
- iii) Tax Incentives
- iv) Cooperation with Large-Scale Enterprise
- v) Promotion of Rural Industry
- vi) Managerial and Technical Guidance and Training Services
- vii) Support for Venture Capital and Technology Development
- viii) Internationalization of SMEs

A. Encouraging Start-up and Stabilization of Business Activity

1. Modernization Program

In 1978 the government launched the modernization program for SMEs under the SME Promotion Act. The modernization program

aims to enhance productivity of small enterprise through facility modernization, managerial rationalization, and technology improvement. The program was financed by the modernization promotion fund. Any small and medium enterprise could exploit the benefits of this program, provided that its plan for modernization was submitted to, and approved by the Ministry of Trade and Industry (MTI). The program has continued until it was integrated into the structural adjustment program in 1989.

2. Identification of High Growth Potential Firms

In 1983, the Government developed a program to identify 1,000 promising SMEs per year. These must have the potential for high growth, and would total 5,000 over a five-year period up to 1988. This program was designed to support enterprises which produce basic metals and parts, whose products have potential for import-substitution or whose products can be exported in the immediate future, as well as firms designated by the Government for specialization in specified areas. The designation was made by the SME-related institutions, such as Small and Medium Industry Promotion Corporation (SMIPC) and the Korea Institute for Industrial Economics and Trade (KIET), etc.

3. Mutual Assistance Fund

The Mutual Assistance Fund was created in 1984 to prevent SMEs from going bankrupt and to finance joint purchases and sales. The Fund was set up with contributions from the government and from the members of Korea Federation of Small Business

(KFSB). As of end of 1989, the fund reached approximately 1000 billion won(U.S.Dollar 1.5 billion). The loans from the fund carry a concessionary interest rate and are repayable over a three-year period. The fund is managed by the Korea Federation of Small Business.

4. Start-Up Support Program

In 1986, the Small and Medium Enterprise Start-Up Promotion Act was legislated to provide active support for new business through fiscal, financial and managerial assistance. Any entrepreneur who wishes to start a new business and who has proven initiative and technical and managerial abilities qualifies for aid from various SMEs-support institutions, such as the Small and Medium Industry Promotion Corporation (SMIPC), the Citizens National Bank (CNB), the Small and Medium Industry Bank (SMIB), and the Korea Credit Guarantee Fund. In particular, enterprises which are expected to make substantial contributions to export promotion, import substitution, or the expansion of the subcontracting market receive higher priority.

5. Structural Adjustment Program

In 1989, Special Act for Stabilization and Structural Adjustment of Small and Medium Enterprises was enacted to stabilize the business conditions of SMEs and facilitate their structural adjustment. The structural adjustment for SMEs was needed to cope with rapidly changing economic environments such

as wage hikes, import liberalization and weakening international competitiveness, etc. Under this Act, Structural Adjustment Fund was created incorporating SMEs Promotion Fund which was operated under the SME Promotion Act of 1988. The major programs under the new Act include facility modernization, start-up assistance for rural industry, technology and information network development, cooperative activities, etc. Concessional loans are available for research and development and start-up programs. More than 7,000 SMEs utilized the Fund facilities until 1992.

B. Support through Financial Institutions

1. Responsibility Ratios for Commercial Banks

All commercial banks, local banks, the Korean Exchange Bank, and foreign bank branch offices in Korea are required to allocate a certain proportion of their loans to SMEs. The responsibility ratios are 35 percent for all commercial banks, including the Korea Exchange Bank and foreign banks, and 55 percent for local Banks.

In addition, rediscounts of commercial notes issued by SMEs are treated favorably by the Bank of Korea. For example, only 30 percent of the commercial notes issued by big business are rediscounted, while the ratio is 70 percent for SMEs commercial notes. Furthermore, loans to SMEs for technology innovation and for increasing productivity may be supported by much as 50 percent by the central bank.

2. SMI special Banks

There are two special banks assisting SMEs; the Small and Medium Industry Bank (SMIB) and the Citizen's National Bank (CNB). The SMIB, established in 1961, was designed to meet the financial needs of small- and medium-sized manufacturing enterprises with 300 or less employees. The name was changed into Industrial Bank of Korea (IBK) in 1987.

The CNB was established in 1963 to meet the financial needs of enterprises with 100 employees or less. Major sources of CNB funds are deposits, borrowing from the central bank and capital contributed by the government.

3. Korea Credit Guarantee Fund(KCGF)

SMEs generally have difficulty in obtaining loans from financial institutions because they have weak credit ratings due to lack of tangible collateral.

To support those SMEs which lack collateral, the Credit Guarantee Fund Reserve System was first organized in 1961 at the Small and Medium Industry Bank. In 1974, the Credit Guarantee Fund Act was enacted to meet the rapidly expanding demand for such guarantees. Under this Act, the Korea Credit Guarantee Fund was created in the same year.

The sources of funds for the KCGF are yearly contributions from the government and financial institutions. According to the Credit Guarantee Fund Act, all banks are supposed to contribute 0.3 percent per annum of total loans through 1985. The major

activities of the KCGF include credit guarantees, credit information services, management and technical extension services, and investment in SMEs.

4. Secondary Financial Market

All short-term financial institutions and insurance companies are recommended to hold a certain ratio of SME commercial notes in their total commercial note holdings. That ratio was raised from 30 percent to 35 percent in 1983 for short-term financial institutions, and from 25 percent to 30 percent in 1984 for insurance companies.

In addition to this, various measures that expand the direct financial market for SMEs have been adopted. For example, SMEs are allowed to issue bank-guaranteed commercial promissory notes. This facilitates direct financing for SMEs and eases part of their short-run financial needs. Moreover, all banks can endorse payments guarantee for SME bonds

C. Tax Incentives

1. Tax Holidays for Investment Reserve Funds

SMEs can reserve 15 percent of their asset values and deduct the same amount from their taxable incomes during the fiscal year. This investment reserve fund is given three year tax holidays.

2. Special Depreciation Rate

SMEs can deduct 50 percent more for depreciation than other firms. The special depreciation rate is increased to 100 percent for SMEs in designated priority sectors. The same 50 percent special rate is also applied to joint production facilities established through the cooperative program. However, the amount of income freed from taxable income, i.e., the sum of the investment reserve fund and depreciation, cannot exceed 50 percent of taxable income.

3. Export Loss Preparation Fund and Foreign Markets Exploitation Fund

All business firms involved in foreign trade can reserve 1 percent of their foreign exchange earned overseas for export loss preparation and another 1 percent for foreign market exploitation. These sums are subtracted from taxable income. However, a 2 percent ratio for both these contingencies is applied to SMEs.

4. Favorable Application of Investment Tax Credits to SMEs

If a mother company invests in testing and their laboratory facilities for its subcontracting companies, it is eligible for 10 percent investment tax credit. Other types of investment by SMEs such as for automation, replacement of facilities, and facilities for the improvement of employee welfare, are also covered by the investment tax credit scheme.

5. General Management Costs

All business firms can allocate up to 0.1 percent of their annual revenue for general management costs, which include expenses other than wages, interest and other raw-material costs. For SMEs, however, this ratio has been raised to 0.2 percent.

D. Cooperation with large-scale Enterprises

1. Sub-contracting System

In 1975, the government enacted the Sub-Contracting Promotion Act in order to reduce the conflicts and unfair practices of large firms and to promote cooperation between the contract-awarding enterprises and sub-contractors.

Some branches of industry are designated for assistance if they are considered important in promoting small and medium sub-contractors, in advancing the industrial structure, or in strengthening international competitiveness. Major products produced by these industry branches are also designated as subcontracting items, and primary producers in these industry branches are encouraged to sub-contract their production. Large firms already producing designated sub-contracting items are required to report to the Ministry of Trade and Industry on the details of their production performances and on their production facilities and capacities.

Small and medium sub-contractors specializing in the production of designated items or those which are in the

designated industries are advised to submit their plans for facility modernization and product quality improvement, rationalization of plant size, and technological improvement. If their plans are approved by the MTI, they qualify for preferential long-term interest rates and technical assistance. The number of designated items increased from 41 in 1979 to 1,160 in 1989.

2. Reservation of Areas for SMEs

Under the Small Business Coordination Act of 1961, certain industrial sub-sectors can be identified as preserves of SMEs to the exclusion of large-scale enterprises. In the areas identified as the preserves of SMEs, entry or expansion of large-scale enterprises can be permitted only on government approval. In 1979, 23 businesses were identified as appropriate areas for SMEs and they were extended to 237 businesses in 1989. This system helped greatly to prohibit large-scale firms from participating in the areas which are considered suitable for SMEs.

E. Development of Rural Industry

One of the important objectives of developing SMEs is to promote dispersal of industry and balanced regional development. For this purpose, the Local Industry Development Act was legislated in 1970 and the Industrial Placement Act in 1979 which were designed to help promote optimal industrial locations and achieve balanced industrial development. But the policy has not

been very successful in terms of dispersal of industries to rural area in the 1970s. Therefore in 1983, the government launched Rural Industrial Estate Project to promote rural industries by providing various focus of assistance. The local administration units such as city and county are responsible for selecting sites of rural industrial estates. The estates are created with government funds for infrastructure construction. The corporate income tax is 100 percent exempted for three years and 50 percent for the following two years. Preferential loans are also provided for factory construction and equipment purchases. As of July 1992, 188 rural industrial estates were established, and 1,450 SMEs are currently operating in these estates.

F. Technical and Managerial Guidance and Training Service Program

The government offers managerial and technical guidance and training services for SMEs. There are several important government-sponsored institutions, which carry out these programs. The most important institution is Small and Medium Industry Promotion Corporation (SMIPC) which was set up in 1979. The major functions of SMIPC are (i) to provide financial assistance to the selected SMEs including start-up firms; (ii) to provide consulting and training services to the managers of SMEs; (iii) to provide technical services including services of foreign experts invited by the corporation; (iv) to provide services of inducing foreign technology transfer and investment for Korean SMEs, and of inducing foreign investment by Korean SMEs; (v) to provide market and technology information to Korean SMEs.

The Korea Institute for Industrial Economics and Trade (KIET) which was established in 1982 collects and supplies various kinds of information on technology, patent and overseas market. The institute has information counselling center which counsels on technological issues. The Citizen's National Bank (CNB), Small and Medium Industry Bank (SMIB) and Korea Credit Guarantee Fund (KCGF) also provide managerial and technical guidance for the firms to which they provide financial support. the Korea Design and Wrapping Center (KDWC) and KOTRA collect and disseminate various information on design and wrapping, and regional and market information, respectively.

G. Support for Technology Development

1. Financial Support

The financial support for technology development of SMEs can be classified into two types: one is the support through various special funds; the other is the subsidies given to the firms which participate in the development of high tech or basic technology. Examples of the first type include Industrial Development Fund and Industrial Technology Improvement Fund. Both Funds were created in 1986. The Industrial Development Fund, which incorporated the previous specific industry promotion funds such as machinery industry promotion fund, electronics industry promotion fund, etc., aims to assist SMEs in development of pilot products in machinery and electronics, new material and software, and rationalization of production facilities in textiles and

dyeing. the Industrial Technology Improvement Fund, which consists of contributions from Oil Reserve Fund, finances new product development, productivity improvement and development of common bottleneck technology. Both funds are provided at preferential interest rate.

There are two kinds of high tech related assistance: one is Specific R&D Project Fund for which the Ministry of Science and Technology is responsible. This fund finances important national R&D projects and high technology development. SMEs engaged in high tech or basic technology development were eligible for the facilities of the fund. About one-fourth of the fund is currently allocated to innovative SMEs.

The other is the Basic Industrial Technology Development Project which was created by the Ministry of Trade and Industry in 1987. The project was established to assist SMEs in development of common basic technology by financing some portion or entire development costs.

In 1989, the Korea Technology Credit Grantee Fund was created in order to extend credit guarantee to SMEs engaged in technology development. As of the end of 1992, its outstanding credit reached 1,274 billion won(US\$ 1.6 billion) for 7,931 SMEs.

2. Taxation Support

There are three major fiscal incentives for technology development of SMEs; reserve fund systems for technology development, tax exemption for R&D and manpower development, and special depreciation allowances.

All business firms can reserve as much as 1.5 percent of their revenues for technology development. When they use domestic equipment 2 percent of reserve fund are allowed. SMEs can additionally reserve 5 million won more. 3 percent of investment tax credit is given for commercialization of new technology. Technology and manpower development expenditure is eligible for investment tax credit of 10%. 30 percent of special depreciation allowance is given for new technology commercialization activity (50% in the case of domestic machinery). 90% of special depreciation rate is given for R&D facilities and 30% for manpower training facilities (50% in the case of domestic facility utilization).

3. Support for Venture Capital and Technology Intensive SMEs

Venture capital is needed by the new technology-based SMEs which are not listed on the securities exchange market and have difficulties in finding investors. Venture capital firms such as Korea Technology Development Corporation (KTDC) and Korea Technology Finance Corporation (KTFC), were established in the early 1980s to help finance venture business. The SMEs Start-up Promotion Act of 1986 promotes venture capital firms in order to assist technology- intensive small firms. Under this Act, 54 venture capital firms were registered as of the end of 1992. Unlike the technology financing companies already mentioned, these 54 venture capital firms are only allowed to invest in equities and convertible bond of SMEs issued within five years of establishment.

H. Internationalization of SMEs

1. Support of Trade Promotion

Internationalization has been a major policy objective of the government in the 1980s. An important policy action to this end was to simplify and reduce procedure and trader's licensing requirements, so that small firms can easily enter the international market. The requirements for entering export and import business has been greatly relaxed and reduced. A variety of information services were provided through organizing exhibitions of Korean-made parts and components, inviting foreign procurement missions, assisting SMEs in attending international exhibition and trade fairs, and disseminating overseas market information, etc. The activities of Korea Trade Promotion Corporation (KOTRA) and the Korea Federation of Small Business have been very much strengthened in this regard.

2. Expansion of Overseas Investment

From the mid-1980s, SMEs began to adopt an internationalization strategy to successfully cope with the challenges of the rapidly changing economic environments, such as appreciation of the won, wage hikes, and opening of domestic market.

Assistance in a variety of forms was given to SMEs to undertake overseas investment. The Export-Import Bank of Korea finances up to 90 percent of the funds required for SME overseas investment at a fixed rate of 7 percent per annum with a maximum 10-year repayment period. From 1992, Small and Medium Industry

Bank began to participate in the activities. In addition, the government simplified overseas investment procedures, and provided more information about foreign investment through the Center for Overseas Investment Service at SMIPC.

3. Inducement of Foreign Investment and Technology

The government actively encouraged joint venture in order to have access to the latest technology. Foreign investment has been greatly liberalized in the 1980s. Automatic approval is given for foreign investment not exceeding US\$ 3 million. The government has also expanded the list of eligible industries for foreign investment, and currently 977 out of the 1,148 sectors are eligible for foreign investment. The liberalization of foreign investment benefitted SMEs more than large-scale firms since SMEs are preferred in general by foreign investors. Six free trade zones have been developed for attracting foreign investment in export industries. Technology import was liberalized. From 1984, approval system was replaced by report system.

VI. PROBLEMS FACING SMEs

The SMEs sector has made remarkable progress in the 1980s due to promotional measures taken by the government. Nevertheless, they are confronted by a number of problems that have to be resolved for continued growth in the future. The major problems and constraints facing Korea's SMEs can be summarized as follows.

First, One of the most serious problem facing SMEs is manpower shortage, particularly in unskilled production workers. As the Korean economy continued to enjoy a high growth rate with more or less full employment for almost ten years, the labor shortage has become very acute in almost all sectors, resulting in rapid wage increase. The labor shortage is particularly serious in the SMEs sector because wages are much lower than in large-scale firms and working conditions and fringe benefits are not as attractive as in large-scale firms. On the other hand, the demand for skilled workers, technicians and engineers is ever increasing as Korea's industrial structure moves toward technology-intensive industries. As a result, manpower shortages in the SMEs sector are far more serious than in large-scale firms. In 1989, a manpower shortage ratio of production workers (defined as manpower demand divided by number of production workers) reached 10.1 percent, almost three times higher than that of large-scale firms (see table 11).

<Table 11> Shortage Ratios of Production Workers in Manufacturing

(unit : %)

	1983		1989	
	LSEs	SMEs	LSEs	SMEs
Production Workers	2.91	3.85	3.46	10.10
Supervising	0.72	0.86	1.35	8.09
Skilled	1.85	3.96	2.30	8.24
Semi-Skilled	2.15	7.76	3.36	10.80
Unskilled	6.24	5.65	9.30	18.54

Source : Ministry of Labor Affairs

In addition to labor shortage, the high turnover rate of blue-collar workers constitute important obstacles to the growth

of SMEs. The turnover rate of blue-collar workers in the SMEs is much higher than in large-scale firms. In march 1990, turn over rate of production workers was 5.8% compared with 3.0% of large-scale enterprises. (See Table 12) Accordingly, the number of service years of workers at SMEs is short. According to a survey conducted by the Korea Federation of Small Business, the average service years at firms with 30 to 99 workers were 2.4 in 1990, which is half the figure of those firms with more than 500 workers. Therefore, labor supply to small firms is volatile and volatility is likely to increase with the widening wage gap.

< Table 12 > Turnover Rate of Production Workers in SMEs

(unit : %)

	LSEs	SMEs	Manufacturing Ind.
1985	4.5	6.6	5.6
1988	3.7	7.7	5.8
1990	3.0	5.8	4.4

Source: Korea Federation of Small business.

< Table 13 > Labor Productivity of SMEs Compared with LSEs

(As percentage of labor productivity of LSEs)

	1975	1980	1982	1983	1984	1985	1986
Korea	55.4	55.0	48.7	48.8	46.3	47.2	47.0
Japan		50.6	48.4	49.1	47.8	47.5	50.0

Source: Major Statistics of Small and Medium Industries, SMIPC, 1989.

The second important constraint for the SMEs sector development is low productivity combined with weak R&D activities. As shown in table 13, the labor productivity of SMEs

in 1986 is less than half of large-scale firms. What is striking is the fact that productivity of SMEs relative to large-scale firms tended to decline since the mid-1970s. The low productivity of SMEs relative to large-scale industries is to some extent attributable to lower productivity growth of small firms. In 1984, for instance, the productivity of small firms with less than 20 workers accounted for only 30 percent of large-scale firms. But these small firms grew much faster than medium-scale firms, thereby contributing to the widening productivity gap between SMEs and large-scale firms.

<Table 14> Capital/Labor Ratio in Manufacturing

(in 1000 won, current prices)

	1975(A)	1980	1984(B)	B/A
SMIs	0.971	2.713	3.968	4.1
LSIs	2.279	6.613	13.526	5.9

Source: Financial Statement Analysis, Bank of Korea, 1977, 1985.

The differences in the technological sophistication may be another factor responsible for widening productivity gap between small firms and large-scale firms. As shown in the table 14, the capital labor ratio, which can be used to reflect the technological sophistication, didn't increase in SMEs as much as in large-scale firms between 1975 and 1984. This may imply that the SMEs largely relied on traditional technology while large-scale firms increasingly relied on modern technology.

The weak R&D activities of SMEs should also have contributed to their lower productivity growth. The R&D/sales ratio of SMEs in 1989 was 0.19 percent which is considerably lower than the

average ratio of 2.1 percent for the manufacturing sector as a whole. This low R&D/sales ratio did not improve much during 1980s. (See table 15)

<Table 15> The Annual R&D Expenditure of SMEs in Manufacturing Industries

(unit : million won)

Year	Sales (A)	Number of establishments	R&D expenditure (B)	B/A (%)
1982	19,532,000	5,300	30,109	0.20
1983	24,592,463	6,031	60,103	0.20
1984	20,073,232	5,103	60,769	0.22
1985	29,543,211	5,630	64,155	0.22
1986	30,000,970	6,664	94,496	0.25
1987	49,573,355	7,522	100,609	0.22
1988	57,426,486	9,821	165,545	0.29
1989	64,740,309	5,962	119,622	0.19

Source : Korea Federation of Small Business.

The particularly low R&D/sales ratio is found for the firms with less than 50 workers which spent only 0.05 percent of their sales for research and development in 1985. These small firms rely mostly on labor intensive technology and hence do not see any strong necessity to carry out R&D activities. According to a survey conducted by Korea Federation of Small Business, only 10.3 percent of SMEs conducted R&D activities in 1989. The R&D expenditure per firm is very small, amounting to 20.1 million won, or 25,000 U.S. dollars in 1989 prices.

There are a number of innovative SMEs which spent more than 10 percent of their sales, but these firms were very limited in number. Therefore, they did not affect overall R&D activities of SMEs.

The third major constraint for the SMEs development is the weak cooperative relationship between large-scale firms and SMEs.

Since the major export industries such as electronics and automobile industry are basically assembly industries which need thousands of parts and components to produce a final product, the quality of final products are largely determined by parts and components produced by the sub-contractors. But sub-contracting system is still underdeveloped in Korea. The large firms place orders to sub-contractors for those parts and components requiring low technology and having low value added, while important parts and components requiring sophisticated technology are either imported or manufactured by themselves. There has been no systematic technological cooperation between order-placing firms and sub-contractors, and hence sub-contractors could not substantially improve their technological and managerial capabilities. This weakness imposed a significant constraint on the development of the overall sub-contracting system in Korea. There has been no substantial assistance from primary firms.

According to a survey conducted by the Korea Federation of Small Business in 1989, 60.3 percent of sub-contractors surveyed did not receive any kind of assistance from contracting firms. The most common form of assistance they received was the supply of raw materials, accounting for 40% of the total assistance received. 15.5 percent of sub-contractors received managerial and technical assistance, and only 5.7 percent received financial assistance.

The fourth important problem facing SMEs is deterioration of the business environment for SMEs. Since the mid-1980s, wages

went up rapidly, surpassing the productivity growth. As a result, the unit labor cost in SMEs increased considerably in the latter half of 1980s. The frequent labor disputes coupled with the won depreciation eroded their international competitiveness. SMEs are also facing severe competition from abroad in the wake of trade liberalization. The cheap foreign products are penetrating domestic market, successfully competing against the products of SMEs. The competitive edge based on cheap labor fades away, compelling many SMEs to go overseas. Due to deteriorating business environments SMEs have been suffering from falling profit margins in recent years. According to Bank of Korea, operating profit as percentage of total sales decreased from 3.6 percent in 1986 to 2.78 percent in 1990.

The last, but not least, important constraint is the financial weakness of SMEs. Traditionally, SMEs suffered from financial difficulties. Due to low credit standing and lack of collateral, they enjoy markedly less facilities of financial institutions, relying heavily on the curb market. Financial support of various forms have been extended to SMEs, but they are too small to meet the demand of SMEs. AS a result, the debt/equity ratio of SMEs despite improvements in recent years remained very high at 339.5 percent in 1990, which is substantially higher than that of large-scale firms (See table 16)

< Table 16 > Debt/Equity Ratio of SMEs
(unit: %)

	1983	1985	1988	1990
SMEs	357.8	369.6	357.7	339.5
LSEs	360.6	344.7	283.9	274.5
Manufacturing	360.3	348.7	296.0	286.3

Source: Financial Statements Analysis, various years, Bank of Korea

VII. CHARACTERISTICS OF KOREA'S SMEs DEVELOPMENT POLICY AND IMPLICATIONS

The SMEs sector in Korea suffered a considerable setback in the sixties and seventies, but it improved rapidly in the eighties. This decline and rise of the SMEs sector was greatly influenced by government policies. Therefore, it may be worthwhile to highlight some of important characteristics of Korea's SMEs development policy in order to derive some lessons from the Korean experiences. The major important characteristics of SMEs development policy in Korea and its implications can be summarized as follows.

First, the overall development strategy in terms of incentive system has played a crucial role in affecting SMEs development. The decline of SMEs sector in the sixties and seventies, and rise in the eighties are basically attributable to the difference in the nature of development strategy and its associated incentive schemes. As noted earlier, the incentive system in the sixties and seventies was characterized by excessive support for export and heavy and chemical industries.

By excessive support it is meant that the sectors receiving incentives are heavily subsidized relative to the sectors receiving no incentives, resulting in great disadvantage for the latter. In other words, when the incentive scheme is excessive in favor of certain sector of the economy, fragmentary support for any other sector of the economy would not be effective, since the former can override the latter. This is the primary reason why the SMEs policy in the sixties and seventies could not be successful, though efforts were made to promote SMEs.

Excessive incentive is not desirable because it distorts

resources allocation with a number of undesirable side effects. Many structural problems of the Korean economy in the past, such as increasing industrial concentration, long period of inflation, and deterioration of income distribution, were largely conditioned by industrial incentive system of 1960s and 1970s.

Second, the SMEs policy should be complementary to, or at least compatible with, the overall development policy. When the sectoral or individual industrial policy is conflicting with overall development policy, it can not be very successful because the latter can undermine the former.

If they are complementary, they are mutually reinforcing, and sectoral policy can be very effective. The rapid growth of SMEs sector in the 1980s can be regarded as a reflection of the combined effects of overall development policy and SMEs policy. As mentioned earlier, in the 1980s, overall policy emphasis was given to technology and manpower development, while promoting competition through liberalization efforts. The SMEs policy was also geared to promoting innovative activities of SMEs by assisting technology-intensive small firms, starts-ups, facilitating structural adjustment, etc. The liberalization policy was also conducive for SMEs development because it facilitated inflow of foreign investment and technology import from which SMEs greatly benefitted.

Third, the Korea's SMEs policy can be characterized by strong governmental intervention. It is often argued that government should provide only monetary and fiscal incentives avoiding any direct intervention in resources allocation. The effectiveness of monetary and fiscal incentives depends largely on the extent to which they are utilized by SMEs. The Korean experiences suggest that economic incentives are not fully

utilized for various reasons. Therefore, the incentive system should be complemented by other support programs which often involve government intervention in resource allocation. Government intervention may vary depending on the economic situations of the individual country. In the case of Korea, government intervention has been extensive, particularly in financial and industrial sectors in which market is neither well developed nor very competitive.

Thus, the Korean government took several important interventionist measures for SMEs such as compulsory loan system, reservation of certain sub-sectors for SMEs, and picking-up promising SMEs. Despite some criticism regarding the cost and effectiveness of this kind of policy approach, it has nonetheless greatly contributed to the growth and development of SMEs in Korea.

Finally, it should be emphasized that institutional arrangement is very important for the effective development of SMEs. In Korea, there are a number of institutions which are solely catering to the needs of SMEs, such as SMIPC, KCGF, KIET and various venture capitals. The most important among these institutions is SMIPC which provides various programs for SMEs. Since its establishment in 1979, SMIPC has made a quite impressive performance in developing management and technical assistance through consulting and extension services. These technical and management services including training have been very popular among SMEs and demand for them always remained high.

The success case of SMIPC in Korea suggests that appropriate institution building is extremely important for SMEs development. It should be also mentioned that many other institutions such as KCGF, KIET and KTDC made a significant contribution to SMEs development in Korea.

VIII. CONCLUDING REMARKS

The development of SMEs in Korea has been greatly affected by the government policies. Until 1970, the growth of SMEs lagged behind large-scale firms largely because the government policy favored large-scale production based on imported raw materials, intermediate goods and equipment. This kind of development strategy brought about a number of structural problems including imbalance between large-scale firms and SMEs.

Therefore, the government intensified intensive efforts to promote SMEs through a variety of support programs and incentives. Thanks to these promotional measures coupled with favorable general policy framework, the SMEs grew fast since early 1980s, making significant contribution to industrial growth, employment creation, export, and possibly distribution of income. The nature of government policy towards SMEs in Korea was basically interventionist approach in which government is directly involved in resources allocation by protecting them, providing loans with government guarantee, picking-up promising firms, etc. This kind of policy approach has merits and demerits, depending on the stages of development and efficiency of government administrations. So far, it seems that this approach in Korea worked quite well with merits compensating for more than demerits.

The Korean economy is now entering a new stage of development as the economy moves rapidly towards internationalization and globalization. Thus, the fundamental problem facing the Korean economy is how to enhance its international competitiveness so as to successfully respond to these newly emerging challenges. In other words, the Korean economy needs a new policy framework in which initiative by the

private sector and competition are essential for economic growth. We also need to have a renewed look at SMEs, not as a mere object of protection and promotion but as a driving force to upgrade the industrial structure and to enhance competitiveness of the Korean economy. Therefore, the government policy for SMEs should be directed to enhance competitiveness by improving support programs and incentives.

The current support system for SMEs relies heavily on financial services. Other services such as assistance in technology, manpower, information and management, which are increasingly important for SMEs, are insufficient to meet rapidly increasing demand for these services. The factors determining the competitiveness of a firm in this world of globalization and internationalization are changing from the hardware-type physical resources to the software-type knowledge and information services. This is particularly true for small firms where human factors, such as risk-taking, innovations, and flexibility play a vital role in business success. Therefore, increased emphasis should be placed on technological assistance, management and information services, and manpower training.

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