AN UPSURGE OF ENTREPRENEURSHIP IN KOREA

AND ITS POSSIBLE REASONS[1]

Ku-Hyun Jung[2]

OVERVIEW

South Korea has witnessed a great upsurge of new business registration since 1999. This is a new and significant development given the fact that big business groups, often called *chaebol*, have historically dominated the Korean economy. In the past, many observers noted that Korea and Taiwan were examples of two extremes since the former relied very much on big business and the latter relied heavily on small and medium-sized enterprises (SMEs). The recent significant increase in the number of small firms in Korea could mean that the traditional business model in Korea may be replaced by a new model where new ventures and SMEs account for a bigger share of the economy and contribute more to the country's economic growth.

Since this phenomenon of greatly increased entrepreneurship in the country is relatively new, we have to work with limited information. As a result, whatever explanations we come up with may be still tentative hypotheses. As more experiences are added and more data are analyzed, one may able to show convincingly what has really happened during the period following the financial crisis in 1997. In this report, I will first review the statistics and show that there has indeed been a great upsurge of new business registration. In the following section, I will look at possible explanations using a conceptual model. The third section will examine the institutional setup for new ventures and SMEs in Korea and try to determine how important this framework has been in bringing about new entrepreneurial activities in the country. The last section will draw some implications for other Asian countries from the recent Korean experience.

A GREAT INCREASE OF BUSINESS START-UPS IN KOREA

The South Korean economy encountered a serious financial crisis in 1997 and had to ask the International Monetary Fund (IMF) to provide emergency financing. When the IMF agreed to provide the financing in December 1997, it demanded that the Korean government implement a series of structural reforms of the economy. The reform programs included macroeconomic stability measures, trade and investment liberalization and reforms in four major sectors, namely the corporate, public, labor market and financial market. Since then, the Korean economy has gone through the difficult period of recovering from a serious recession resulting from an austere macroeconomic policy as well as a fundamental restructuring of her economy. The period of 1998-2000 coincided with the rapid spread of the Internet and the new venture boom that accompanied it.

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[1] Prepared for Expert Workshop on Entrepreneurship in Asia: Creating Competitive Advantage in the Global Economy, held in Hong Kong, 8-11July 2002.

[2] Professor of Business Administration, Yonsei University, Seoul (jungkh@yonsei.ac.kr)

In addition, the government provided several measures to promote venture start-ups and developed an institutional framework for venture capital and other financing schemes for new business.

Much of the literature on structural reforms related to the 1997 crisis has dealt with government-led reform measures but has not paid sufficient attention to what has been taking place in the marketplace. There have been changes in the major actors of the Korean economy and also adjustments to the people's attitude toward jobs and organizations. The first big change has been the demise of large business firms. The *chaebol* were a major force in the Korean economy before the crisis, but about one-half have gone bankrupt or been seriously weakened due to the liquidity crisis and poor competitiveness. Big business is relevant to the discussion of new business start-ups, since big business and small business share the same economic sphere and their relative importance will change in an opposite direction in the economy.

The Korean government has adopted a system of annually designating the so-called "30 largest business groups," based on asset size. This list is announced by the Fair Trade Commission, and they use the list in order to regulate large business groups in the context of so-called "excessive concentration of economic power." Since the list is updated every year, the actual composition of the companies will change year after year, although large groups topping the list tend to remain in the list over the long term. The share of Korean GDP contributed by the 30 largest business groups has declined during the three-year period of 1997-99 and slightly picked up in 2000. Table 1 and Figure 1 show this trend. The decline of 4.77 percentage points from the peak of 14.98 percent in 1995 to 10.21 percent in 1999 is a very large number since we are dealing with GDP figures. In fact, in percentage terms, it can be said that the share of the 30 largest business groups in Korean GDP declined by almost 1/3 or 31.8 percent to be exact. And most of this decline has come from the smaller business groups that are ranked from 11th through 30th. In contrast, the share of the top five groups changed very little over this period. The decline of medium to small business groups should have created more space for SMEs to operate and for new firms to be created.

Looking at other indicators, the market value of the top 30 business groups has also shown a long-term decline since the late 1980s, although exact shares have been more erratic, reflecting the volatile stock market. However, the relative share of the top four groups has increased over the period. They accounted for 23.2 percent of the total market value of the Korean Stock Exchange in 1996 and their share increased to 48.3 percent in 2000. On the other hand, the share of the next 26 business groups declined from 17.6 percent in 1996 to 5.3 percent in 2000. And 13 so-called groups had a market value that was less than 2 percent of the market capitalization of the largest group, Samsung. Table 2 and Figure 2 clearly show that the economic crisis has dealt a serious blow to second-tier business groups while the top four have in fact increased their share in the Korean economy. If we look at the trend more carefully, we note that the relative decline of second-tier business groups started around 1993-94 and has accelerated with the crisis in 1997. One hypothesis is that the globalization trend began to reward globally competitive companies while punishing also-rans. In any case, it is clear that having the government designate the 30 largest groups does not make sense any more.

Whereas the share of large business groups in the nation's GDP declined during the second half of the 1990s, there was an increase in the total number of business concerns, both incorporated and unincorporated. Table 3 shows that at the end of 1997, there were 2,713,000 business concerns nationwide. And this total number increased by 143,000 over the three-year period 1998-2000. This is the "net" number since it includes new establishments as well as closed-down operations. It is interesting to note in Figure 3 that the total number decreased immediately after the financial crisis broke out at end of 1997. In 1998, the total number of business concerns declined by 72,000, which has been more than compensated by the increase of 137,000 concerns in 1999 and 79,000 concerns in 2000. The serious recession in 1998 meant the reduced demand for products and the liquidity crisis brought about a chain of insolvency emanating from large firms and spreading to smaller ones. But after many firms went out of business in 1998, the number of new establishments almost doubled in 1999. This shows that some of those people who closed down their businesses in 1998 started new businesses the next year and also that there perhaps have been more new firms that were started by new entrepreneurs.

More up-to-date information for incorporated firms is available through the courts since businesses have to be registered with the local courts when incorporated. And these numbers show a more striking picture. A large number of new corporations or "legal persons" were established during the period 1998-2002. Table 4 and Figure 4 show that the number of newly registered corporations (or legal persons) has increased rather markedly since the crisis began. The multiple of new corporations to defaulted corporations was in the range of 3 to 5 times before the crisis but jumped to 12 to 17 times since 1999. If these numbers show the trend correctly, the "entrepreneurial" spirit among the Korean people was kindled for some reason after the economic crisis in 1997.

What we have seen so far clearly shows that the economic crisis has brought about a large number of new business start-ups in Korea. This does not demonstrate that the Korean people are more entrepreneurial than other people. There can be two approaches to the study of entrepreneurship. One approach can be called the "contingency" school, arguing that entrepreneurial activity depends very much on the economic situation. According to this approach, as more human resources are made idle or unemployed, more new business start-ups will take place. The other approach, the "cultural" school, argues that certain peoples or cultures tend to be more entrepreneurial than others. For example, many overseas Chinese have become successful in business, as have Jews and Indians. Similarly, one can argue that the Chinese people seem to have some basic orientation to business, and seem to be more diligent and persevering. Our statistics so far show only that entrepreneurial activity picked up in Korea immediately after the serious economic crisis.

Another study that explored entrepreneurship in Korea in the same period confirms the picture already presented. The Global Entrepreneurship Monitor (GEM) survey of entrepreneurship, conducted in 21 countries in 2000, demonstrated that South Korea tops the charts in entrepreneurial activity. GEM surveyed the adult population and experts in each country as well as conducted an expert interview.[3] The researchers utilized two indicators to measure entrepreneurial activity, (1) the nascent firm prevalence rate and (2) the new firm prevalence rate. The former refers to the percentage of people between the ages of 18 and 64 who are preparing to start a new business, and the latter refers to the percentage of employees who work for the companies with less than 42 months history. South Korea was ranked seventh among 21 countries on the nascent firm prevalence rate and first in the new firm prevalence rate. This 2000 survey shows that one out of 11 people worked for relatively young companies that were established within the last three and half years.[4] In addition, one out of 20 adult Koreans is involved in some kind of new business start-up. It

[3] Paul D. Reynolds, et al., *Global Entrepreneurship Monitor*, (Executive Report, 2000).
[4] Park Yun-Jae, et al., "An International Comparative Study of Entrepreneurial Activity and Conditions: Korean Case," *Journal of Small and Medium Enterprises*, Vol. 23, No. 3, (Sep. 2001): 157-184.

is interesting to note that Japan was ranked last and second to last in the two indicators. In the total entrepreneurial activity prevalence rate that combines two indicators mentioned above, Korea was ranked number two among 21 countries, following Brazil and followed by the United States.

Once again, the GEM study does not prove that Koreans or Brazilians are fundamentally or culturally more entrepreneurial than other peoples. If the survey had been conducted during more "normal" times, one might be able to make this argument. But as I have shown earlier, the 1999-2001 period has been one in which Korea witnessed a great upsurge of entrepreneurial activity, and it is not yet clear which factors have contributed to the sudden upsurge of entrepreneurial activity in South Korea.

EXPLANATION FOR THE SUDDEN INCREASE OF NEW BUSINESS START-UPS IN KOREA: FOUR DETERMINANTS

In this study, we take both the contingency approach and the cultural approach to try to explain the sudden increase in new business start-ups. But the relative weight is placed more on the contingency approach, that is to say that entrepreneurial activity is explained more by the situation in which resources and opportunities interact. Here "entrepreneurial activity" specifically refers to new business creations and is measured by "new business multiples," i.e., the number of new firms over the number of closed-down firms. Between 1994 and 2001, the new business multiple in major Korean cities increased from an average of 4.5 during 1994-96 to an average of 14.3 during 1999-2001, excluding the two immediate years (1997 and 1998) of economic crisis.

Our model and variables should explain this increase of entrepreneurial activity. I would like to propose that there are four major determinants of entrepreneurial activity in a society; Figure 5 shows this simple model. The first variable is business opportunity: the perceived probability of making profits if a new business is undertaken. People will jump into a new business when profit opportunities are foreseen, whether the opportunity is a new gold mine, new trade opportunity, new invention or market distortions that create arbitrage opportunities. Even when the same opportunity is present, people will react differently to it. When people have more resources or capabilities with which to react to the opportunity, they will be more likely to react quickly. Business resources, thus, are the second necessary ingredient to run a business. These include human, financial and knowledge resources. Perhaps resources are the most important variable in determining the entrepreneurial activity of a society.

In addition to these two contingency variables of business opportunities and resources, there are two other variables, namely the cultural factors and institutional factors. Cultural factors include the people's attitude toward wealth, the social status of the businessman, attitudes toward risk and the role of women in society. Many observers hypothesize that the cultural factor does not change in a short period like a few years but may change over a longer period. For example, "commerce" was considered to have low social esteem in the Confucian teachings, but its position may have changed during the rapid industrialization and commercialization of Korean society in the last few decades. The institutional factor refers to government regulation, incentives to new business creation and other financial and business infrastructure elements that support SMEs. To the extent that institutional factors and infrastructure tend to be path-dependent and perhaps more rigid, this variable has a medium-term impact on entrepreneurial activity.

In this section, we will review how each variable helps explain the increase of entrepreneurial activity in Korea during 1999-2001.

BUSINESS OPPORTUNITIES

One important factor during the period 1999-2001 was the venture boom emanating from the Internet. As was true with other countries with a strong information technology orientation, South Korea was hit with the new venture boom of so-called dot-coms in 1999 and 2000. Although the dot-com boom died down by the fall of 2000, the increase of newly registered corporations has not decreased. South Korea has one of the most advanced infrastructures in Internet communications, and the Korean people have shown a willingness to quickly adopt new devices and technologies such as mobile phones and the Internet. The Internet created many business opportunities related to on-line applications. And the venture boom followed with the rapid penetration of the Internet during this period.

But the venture boom alone cannot explain the increase in entrepreneurial activity. South Korea has a venture registration system through which certain incentives are provided to those firms registered as "ventures." The total number of registered ventures was 11,392 at the end of 2001 and the number of newly registered venture firms was 9,350 during the three-year period 1999-2001. This is only about 8.4 percent of the total of new legal persons registered in seven large cities during this period. Since the registration of venture firms is not automatic, there are probably a large number of small start-ups who are working to gain the status of a venture. This means that the actual impact of the venture boom is actually bigger than the number of registered venture firms indicates. But the venture is usually associated with new technology, new invention or a new business method and does not include many conventional industries such as restaurants or traditional manufacturing business. The Internet venture boom may explain only a fraction of the total entrepreneurial activity during 1999-2001.

Another opportunity factor may be new consumer spending and the growth of the service industry. The relative share of personal consumption in Korea's GDP increased during this period and there has been a large increase in the number of service industry firms. The relative share of consumption in GDP has increased in recent years compared to the government sector and corporate investment. And the share of the service industry in the nation's GDP also increased steadily in the 1990s. Here it is difficult to establish a cause-effect relationship because these two developments coincided with the increase of new business start-ups during this period. But people react to perceived opportunity and it is possible that new opportunities in service industries related to the consumer-spending boom have induced potential entrepreneurs to jump at opportunities.

BUSINESS RESOURCES

The second variable in our simple model is called business resources, which includes human, financial and knowledge resources. This variable seems to be a critical factor in the case of Korea's new business boom. Before the economic crisis, large corporations were believed to be safe from bankruptcy and thus were thought by many people to provide long-term employment security, if not lifetime employment. But the crisis resulted in a large number of layoffs, especially of middle-level and senior managers. This should have been a signal to many employees that corporations cannot provide the kind of job security they want. Thus, laid-off workers and employees who have resigned on their own provided much needed human, financial and knowledge resources for new ventures. Financial resources also were available, partly because many of the unemployed workers were given lump-sum severance payments. Most companies do not have pension programs and usually provide lump-sum severance payments. And since many of these laid-off people have had long years of experience in business, they also have basic knowledge and sometimes proprietary knowledge about business and products.

As Table 1 shows, the top 30 business groups employed about 873,000 full-time workers at the end of 1997. During the next two years, the total employment by this business segment was reduced to 586,000 people, a reduction of 287,000 employees or 32.9 percent of the total employees. This magnitude of lay-offs would have been unthinkable during the good old days. The top business groups had to lay off one out of three employees either because some companies closed down or as a part of business restructuring and downsizing. This development should have sent a very strong message to all the workers nationwide. Figure 1 gives two additional pieces of information. One is the delayed effect of employee layoffs during business downturns, with the observed lag of about one year. Another factor is the "overshooting" of employment relative to business downturns. In other words, once companies lay off workers they do not increase their labor force immediately, even when business picks up in the next cycle. In any case, the fact that so many workers lost their jobs with big business should have sent a strong message that no company can provide job security and everyone has to take care of himself.

INSTITUTIONAL FACTORS

The third variable in our model is the institutional factor—in this case, the incentives given by the government. In contrast to a very restrictive policy toward large firms, the Kim Dae-Jung government has been keen on stimulating new business start-ups and promoting SMEs. As mentioned earlier, a system of venture registration was introduced and various incentives were provided to those firms registered as new business ventures. But this system was found to have many undesirable side effects later on, since bribes and corruption accompanied the registration process and incentives. Tax incentives were made available to individuals who invest in new ventures, and venture capital firms were also given preferential treatment by the government. It is difficult to gauge the exact impact of government incentives on new business start-ups. Their impact should certainly be positive but can explain only a small part of the new entrepreneurial activity because they have been concentrated on new ventures and new start-ups in high technology industries. As was shown earlier, ventures and high-tech industries comprise only a small part of Korea's overall new entrepreneurial activity.

CULTURAL FACTORS

The last variable in our model is the cultural factor. As implied earlier, the cultural variable does not change in a short period and may not be all that powerful in explaining the phenomenon that has occurred during a period of a few years. But there seem to be at least two trends that may have influenced the rise of entrepreneurship in South Korea. The first is the changing value system about money and business. The Confucian value system in the past considered commerce to be an occupation with low social esteem. The Korean people have tended to look down upon "money" at least in theory and, in particular, abhorred the demonstration by the rich of conspicuous consumption. But as industrialization proceeded, the relative social status of businessmen and industrialists has risen steadily, and some figures such as Chung Ju-Young and Lee Byung-Chul now occupy very high positions in the popular mind. As the capitalist value system has become more prevalent, money has become accepted as perhaps the most important measure of success among the ordinary people.

Another factor is the development of democracy and the market economy. South Korea's march toward democracy has moved forcefully since 1987. Democracy means people now have a freer choice and this advances the development of the market economy, which relies heavily on individual freedom. It is true that South Korea's oligarchic economic structure has outlived its oligarchic political structure. In other words, the power of government bureaucrats and big business tycoons is still very much a part of the Korean economic system. But the economic crisis of 1997 resulted in a major restructuring of the corporate governance system, moving South Korea from a system dominated by large shareholders and government bureaucrats to a system where other stakeholders, such as small shareholders, employees, buyers and the local community, have a much stronger voice in corporate decision making. This relative power shift and development of a multi-stakeholder business model means that the Korean capitalist system has begun to value individual freedom and the creative energy of entrepreneurs.

There is some evidence that the creativity and entrepreneurial vigor of Koreans have been rekindled in the last several years. Perhaps this is due to fundamental shifts in the value system and socio-political governance system, which have unleashed the creative and entrepreneurial energy that has always been present in the Korean people. (This is such a bold statement.) One piece of evidence is the significant increase in the number of new patents registered with the National Patent Office in recent years. Another is the large number of Korean businessmen working all over the world. One can meet Korean businessmen and see Korean restaurants even in such remote places as Central Asia or Africa. Further evidence is the recent popularity of Korean pop culture in East Asian countries. To confirm this conclusion, there is a need for a more systematic study about the creative and entrepreneurial energy of the Korean people that has been unleashed suddenly in recent years. But I would argue here that the increase in entrepreneurial activity in recent years is based on a more fundamental shift in the value system and socio-political developments in South Korea.

Related to social developments is the changing role of women and young people in Korean society. In a society of Confucian values, women have been asked to be obedient to husbands and men and have been denied higher education and professional positions. But in South Korea, this has changed very much over the last three decades. First, the numbers of college-educated women and men are almost equal and more women are enrolled in such traditionally male-dominated disciplines as business and engineering. Second, more women are participating in business. It is estimated that about 33.9 percent of all business establishments in Korea were owned or headed by women in 2000.[5] Many of these businesses are assumed to be small service operations relying on family labor. Female participation in large firms in higher positions is still very limited. However, it is expected to increase gradually in the future, reflecting the kind of education women have been pursuing in recent years.

[5] Korea National Statistical Office, *2000 Census on Basic Characteristics of Establishments*, (2001).

In a Confucian society, young people are expected to be obedient to old people and the social hierarchy has been strongly influenced by age. This is also changing rapidly. The seniority-based system is very rapidly being replaced in many companies by a merit-based pay and promotion system. And young people in their 20s and 30s are the mainstream in venture start-ups. This is a very important new development. In the past, it was very difficult for young people in their 20s to start a new business. But young people have found it easier to start a new business in IT-related industries because of their prowess with computers. In short, Korean society, which has been dominated and governed by older men in the past, is embracing women and young people as important actors in the Korean economy.

Another major development in the corporate scene in Korea is the entry of a large number of foreign firms. There were two developments that have led to the rapid increase of foreign direct investment (FDI) in Korea after the Asian financial crisis. The first was the deregulation of foreign takeovers of Korean companies after the crisis began and the second was the sellout of assets and businesses by the companies that were hit by a liquidity crunch. Since most Korean companies had to scramble to get cash in the midst of unusually high interest rates, most Korean companies were excluded as potential buyers of these assets. Foreign firms were realistically the only potential buyers, and they had the added strong incentive to invest because Korean assets became much cheaper due to the significant depreciation of the Korean won. In a sense, this was a fire sale. As a result, a record amount of FDI came into the country during 1998-2000. Based on balance of payment accounting, the total amount of FDI during this three-year period amounted to $23.5 billion, exceeding the total cumulative stock of FDI at the end of 1997, which is estimated to be $15.3 billion. This open-door policy has many implications, one of which is that people now have more choice in terms of both employment and products. This wider choice also means that people are exposed to more diversity in the marketplace, which in turn will help to develop their creativity.

More active participation by foreign firms in the Korean economy will have additional benefits. First, they will add a new element of competition in the market and will be a source of new technology and management know-how. In addition, they will probably reduce arbitrary government intervention in industries and encourage the government to act in accordance with the Rule of Law. Moreover, one can argue that globalization means that countries will become more specialized in those industries where they have competitive advantages. In any case, the increased role of multinationals in the Korean economy as well as the active participation of global capital in the Korean stock market means that the economy is exposed to evaluation and action of foreign capital and thus has to adopt so-called "global standards" more diligently. This new development will indirectly affect entrepreneurial activity in the national economy.

THE IMPACT OF GOVERNMENT POLICY AND OTHER FACTORS IN PROMOTION OF ENTREPRENEURSHIP

The Korean government has implemented a myriad of policy measures to help SMEs. Perhaps the most important is the credit guarantee system, by which SMEs get credit guarantees from government-owned financial institutions in order to obtain bank loans. Every year these credit guarantee institutions incur substantial losses to cover the defaulted loans that they had previously guaranteed. There is a strong incentive to cheat on the part of businessmen and thus room for moral hazard. But this system has been in existence for a long time and has been maintained as a necessary mechanism to help SMEs obtain bank loans.

Another important SME policy measure was the designation of certain industries as off-limits to big business. This policy has had an anti-competitive effect and has been found to weaken those industries that are protected in such a way. SMEs in those industries have become complacent in quality improvement and technology development. This policy measure is now being withdrawn gradually by reducing the number of industries with this designation. In addition to these measures, the government has implemented human resource development, technology development and management consulting services to assist SMEs.

In the view of this author, though, these measures are not really helpful in explaining the upsurge of new entrepreneurship since they have been in existence for the last few decades. Furthermore, these SME measures have had the effect of salvaging and maintaining existing SMEs rather than encouraging new business start-ups. In other words, most SME policies tend to provide exit barriers to weak companies by furnishing financial and other incentives to remain in business but they do not make it easier for potential entrepreneurs to start a new business. One can even argue that many of the SME measures are detrimental to the development of entrepreneurship.

In explaining the recent increase of new business start-ups in Korea, the only relevant government policy is the new incentive system related to new ventures. As was previously mentioned, the Korean government designates certain companies as ventures and provides financial and fiscal incentives. This incentive system may have induced more potential entrepreneurs to start new businesses, but it also has many undesirable side effects. Decisions about new ventures should be left to the private capital marketplace and individual entrepreneurs because the success rate of these government-designated ventures is very low and public funds should not be used to finance such high-risk businesses. But the Korean government has had a long history of industrial policy, and government bureaucrats have the habit of interfering in private business, big and small.

In the developmental period of the 1960s to the 1980s, Korean government economic policy has favored big business since its aim was to develop capital-intensive industries with large economies of scale. In an effort to remedy this policy bias, the government has introduced various measures to promote SMEs. But the government SME policy has been ineffective since resources and investment were diverted to and concentrated in the big businesses to begin with. In the 1990s, however, government industrial policy became more neutral. As a result, the relative share of large business groups has declined since the early 1990s. It is argued here that specific policy measures or incentives to promote SMEs are not really effective. More important are general policy neutrality and the functioning of the financial market.

Finance and taxation are perhaps the two most effective government policy instruments affecting business behavior. During the developmental period, the Korean government utilized commercial banks as agents of government industrial policy. The government owned those commercial banks and directed them to channel credit and funds to certain targeted industries. This particular industrial policy was one of the causes of the financial crisis in 1997. Since the crisis, there has been a major reform of the financial market. One of the big changes was to make these commercial banks really "commercial" in the sense that they make loan decisions based on the credit and risk of potential borrowers. The commercialization of bank management can have a negative impact on

SMEs since small firms are typically at a disadvantage in their credit ratings relative to large companies. But the size of a firm may be only one determinant of company credit, and smaller firms could have a better credit rating based on sounder financial structure or better business performance. For example, Korean banks have significantly increased consumer loans in recent years in order to reduce the risk associated with lending to large firms. It is yet to be seen how this change in the financial market will affect access to capital by SMEs.

Other than government policy, several other factors that may affect the entrepreneurial activity deserve mention. One is the existence or absence of a social safety net in a society. If it is true that people laid off from big business provide the best source of entrepreneurship, the social welfare system can have an intervening effect. For example, if a country has a very elaborate and generous unemployment insurance system, laid off workers will find it easier to rely on unemployment benefits rather than undertake the difficult task of starting a new business. This may be the case of some European countries. European Union (EU) countries have a very high unemployment rate, but it is not clear whether entrepreneurial activity is strong. In Korea, the unemployment insurance scheme has limited benefits, in terms of both the duration and amount. This may have influenced some unemployed Koreans in their decision to start a new business. We do not have the data to show how important the inadequate social safety net has been in influencing entrepreneurial activity in Korea.

One last comment is the correlation between entrepreneurial activity and economic growth. This correlation is very difficult to establish statistically. In general, the two variables interact with one another. High economic growth means more business opportunities, which in turn will induce new business start-ups. On the other hand, strong entrepreneurial activity means more investment and innovation, which will in turn have a positive effect on economic growth. In the case of Korea, it is still too early for start-up firms to have had a tangible effect on economic growth. With the exception of small service firms, it generally takes a few years for a new business to develop products and become profitable. Since the number of new business start-ups in Korea has increased since 1999, their impact on economic growth will more likely be felt in 2002 and beyond. But the relatively robust performance of the Korean economy since 2000 may be positively correlated with the strong entrepreneurial activity since 1999.

CONCLUDING REMARKS AND IMPLICATIONS

The great upsurge of entrepreneurial activity in Korea in recent years is a very interesting phenomenon and has to be carefully studied. This development has some useful implications for middle- to low-income countries. As was suggested, the possible reasons for the sudden increase of entrepreneurship in Korea are still tentative and should be more systematically researched. Based on the limited evidence we have, the following observations can be made:

The most important reason for vigorous entrepreneurship in Korea seems to be due to the business resources variable, more specifically resources made available from big business in the process of restructuring. Big business groups reduced their total employment by about one third immediately after the Asian economic crisis erupted in 1997. This development provided the financial, human and knowledge resources required in the start-up of new businesses. There is a paradox in this situation because in general, job security is a good thing for workers. However, for the economy as a whole, flexibility in the labor market is much more beneficial to the economy than the rigidity that accompanies job security.

South Korea has a relatively powerful labor union and it is known for labor market rigidity. If there had not been an economic crisis in 1997, it would have been impossible for companies to lay off workers on such a scale, and probably the degree of entrepreneurial activity would have been much smaller than what has actually occurred. There is a need for further studies that would support this argument. But looking at the U.S. and Japanese economies gives us some support for this argument. The U.S. economy is known to have a high degree of labor market flexibility, which correlates with economic dynamism, whereas the Japanese economy has low labor flexibility and a long period of economic stagnation. This relationship should be studied more carefully, though, because before the late 1980s, lifetime employment was considered a key strength of the Japanese economy. Perhaps the economic environment has changed to make labor market flexibility a more important factor in economic growth.

Another factor that is important in igniting the latent entrepreneurial energy present in the Korean people seems to be the economic and political system. Democracy and the development of a market economy tend to stimulate creativity and entrepreneurial energy. In Korea, political democracy, economic liberalization, and an open-door policy all have contributed to the development of individualism, creative thinking and new business energy. This process started with the development of the middle class, which was made possible by rapid industrialization and income growth. The democratization that began in 1987 has brought about the replacement of an oppressive government with a more democratic one. The economic crisis in 1997 resulted in the relative weakening of the oligarchic economic structure dominated by government bureaucrats and big business. And the open-door policy that has been slowly implemented since the late 1980s has brought about an economy where individuals are provided with more choices in jobs and products. All these developments have created an environment where creativity is valued and entrepreneurship is rewarded with profits and wealth.

These arguments make it clear that specific government policy instruments are less important than the overall business climate in promoting new ventures and entrepreneurship. Various measures used by the Korean government to promote ventures may have had some positive effects but they also had many negative effects and resulted in social problems. There is little evidence to suggest that the Korean government's SME policy has been effective in promoting small business. In particular, the government's SME policy provides artificial exit barriers by maintaining companies that should go out of business. This in turn adversely affects new business start-ups. Creating space for SMEs to operate appears to be more important in facilitating new enterprise creation than government policies, and this "space" has been made possible by the demise of large firms, which in turn has been caused by the economic crisis. Direct intervention by government will in fact induce opportunistic behavior and moral hazard among businessmen.

APPENDICES

Table 1. Share of *Chaebol* in the Korean Economy

Year	Share of The Largest 30 Business Groups (%)1)	Total Employees of 30 Business Groups
1991	12.89	804,794
1992	13.14	789,071
1993	12.97	796,206
1994	13.35	835,954
1995	14.98	899,274
1996	13.61	949,369
1997	11.97	873,169
1998	11.94	731,136
1999	10.21	585,775
2000	12.74	629,524

Note: 1) Based on Value Added by the Largest 30 Groups
Source: Choi Sung-No, The Korean Big Business Groups,
Seoul: Center for Free Enterprise, (1997, 1999 and 2001).

Figure 1. Share of *Chaebol* in the Korean Economy

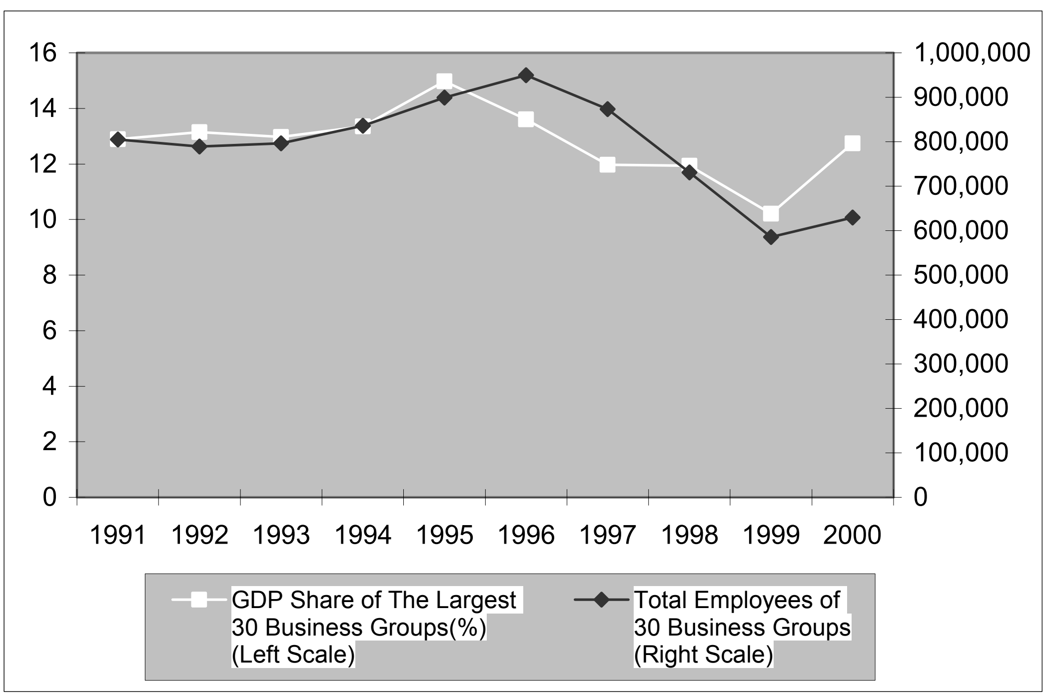


Table 2. Korea: Market Value of Business Groups (Percentages)

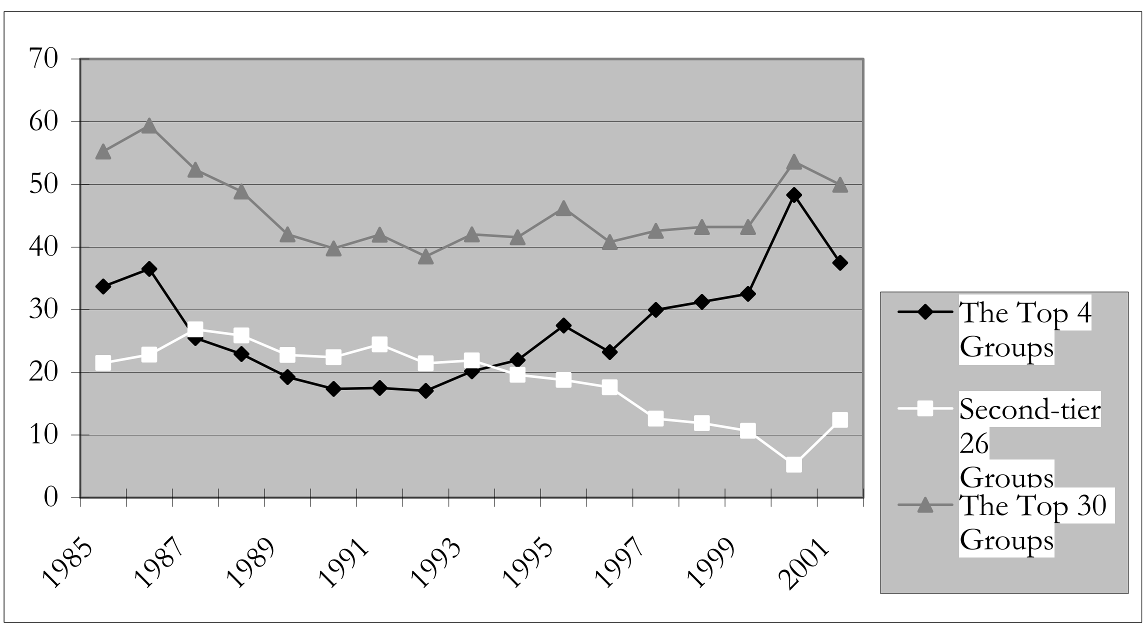
Year	Top 4 Groups	Next 26 Groups	Top 30 Groups
1985	33.72	21.51	55.23
1986	36.53	22.84	59.37
1987	25.48	26.85	52.33
1988	22.95	25.89	48.84
1989	19.25	22.75	42.00
1990	17.38	22.41	39.79
1991	17.50	24.45	41.95
1992	17.05	21.44	38.49
1993	20.15	21.89	42.04
1994	21.94	19.62	41.56
1995	27.45	18.78	46.23
1996	23.22	17.59	40.81
1997	29.98	12.60	42.58
1998	31.26	11.92	43.18
1999	32.51	10.67	43.18
2000	48.32	5.28	53.60
2001	37.49	12.42	49.91

Source: Korea Stock Exchange

Notes: 1. The numbers indicate the share of these groups out of the total capitalization of the Korea Stock Exchange, as of end of year for 1985-98 and as of April (various dates) for 1999-2001.

2. The top four groups refer to Samsung, Hyundai, LG and SK for all the years, whereas the next 26 groups can vary depending on the list provided by the Fair Trade Commission each year.

Figure 2. South Korea: Market Value of Business Groups (Percentages)



Note: See Table 2 for notes and the source of information.

Table 3. Total Number of Business Establishments in Korea

Year	Incorporated Firms	Unincorporated Firms	Total
1993	171,744	2,044,611	2,216,355
1994	121,589	2,287,482	2,409,071
1995	140,921	2,513,818	2,654,739
1996	147,291	2,526,709	2,674,000
1997	155,799	2,557,123	2,712,922
1998	146,710	2,493,895	2,640,605
1999	165,018	2,612,237	2,777,255
2000	181,259	2,674,780	2,856,039

Source: KOSIS in Korea National Statistical Office (http://kosis.nso.go.kr)

Figure 3. Net Increase of Business Establishments in Korea

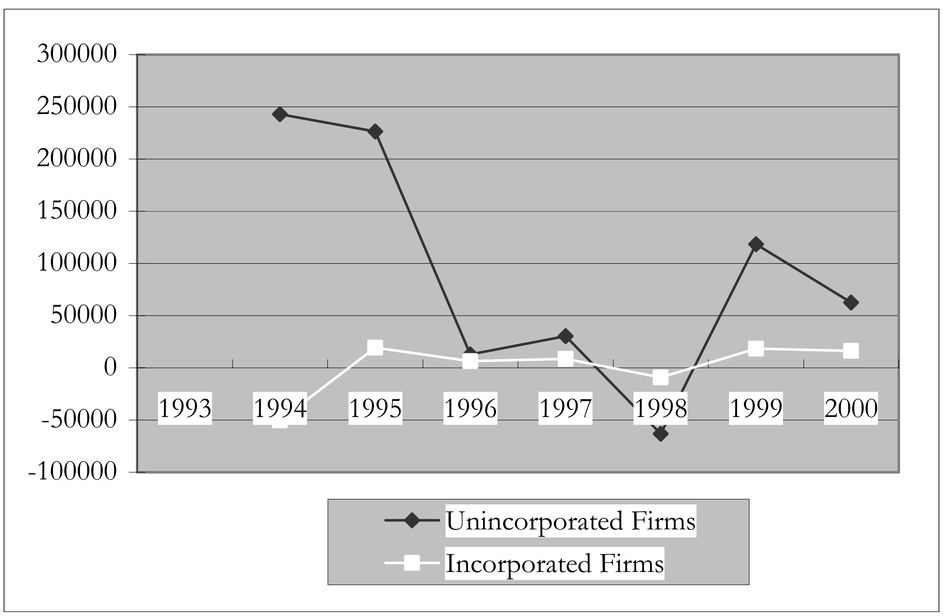


Table 4. South Korea: Entry and Exit of Business Firms (1993~2001)

Year	Top 7 Cities Only		Total Number of Illiquid Firms (nation-wide)	Incidents of Unpaid Notes (%)	A/B
	New Corporations (A)	Illiquid Corporations (B)			
1993	11,938	2,669	9,502	0.13	4.5
1994	16,723	3,573	11,255	0.16	4.7
1995	17,245	4,559	13,992	0.17	3.8
1996	19,264	3,879	11,589	0.14	5.0
1997	21,057	6,132	17,168	0.4	3.4
1998	19,277	7,538	22,828	0.38	2.6
1999	29,976	2,429	6,718	0.33	12.3
2000	41,460	2,800	6,693	0.26	14.8
2001	39,609	2,349	5,277	0.23	15.7

Source: Bank of Korea and Korean Federation of Small Business (http://stat.kfsb.or.kr)

Figure 4. South Korea: Entry and Exit of Corporations in Seven Cities (1993~2001)

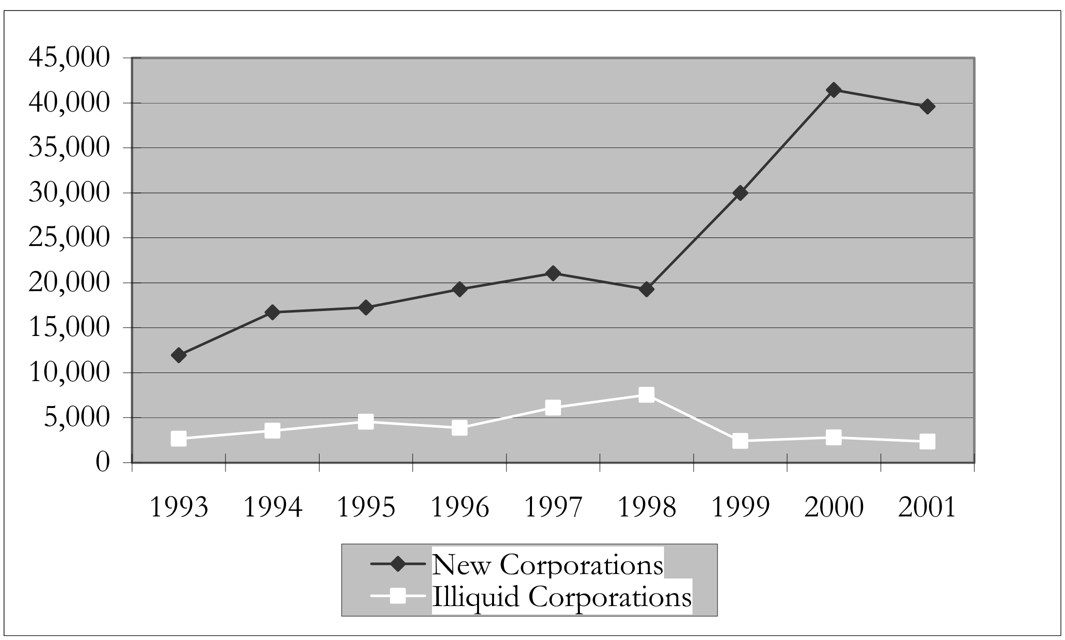
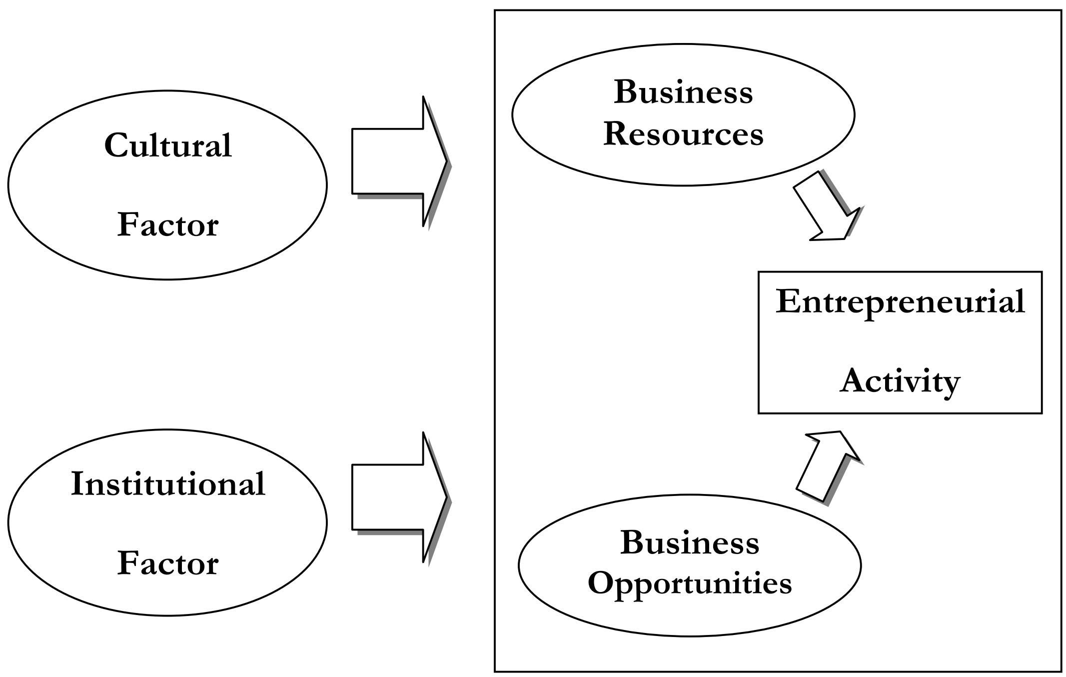


Figure 5. Determinants of Entrepreneurial Activity



Ku-Hyun Jung is a Professor and Dean of Business Administration at Yonsei University, Seoul, Republic of Korea, as well as a consultant to business and government and a member of the Board of Directors of several business and nonprofit organizations, including the Hyundai Construction and Engineering Corporation. Dr. Jung is a graduate of Seoul University and holds an M.B.A. from the State University of New York. He received his Ph.D. from the University of Michigan in 1976. Prior to joining to the faculty at Yonsei University, he taught at several other institutions including the Chinese University of Hong Kong, the University of Hawaii, the University of Michigan and the University of Washington. He has published extensively and is an internationally recognized authority on business and philanthropy in Korea.