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Abstract

Korean small businesses have come a long way as sources of industrial power more important than heretofore credited. The nation's undemocratic *dirigisme* had largely slighted small businesses to the country's disadvantage. Although the government's policy bias against them started to change in the early 1980s, its support of them remained less than fully-fledged. Despite tough socio-economic conditions, however, both the first and second generation small entrepreneurs have strived to prove their self-worth as viable business enterprises and constantly – and increasingly over time – contributed to the incremental improvement of the economy. By shedding light on the little-known motivations, perceptions, and performances of the small business people, this article offers a more balanced and nuanced account of the past and present state of small businesses in the country, which provides a tentative basis for considering alternative vision for future development.

Key words: South Korea, Small Business, Developmental State, Financial and Industrial Policy, Bottom-up Clusters, Industrial Districts.

JEL classifications: D63, G28, H11, L52, L60, O21

The *Dirigiste* Legacy

The abrupt adjustment in the early 1980s of Korea's[1] highly *chaebol*-biased modernization strategy resulted in a less discriminatory flow of industrial credits to small business.[2] Changes in state policy, however, were not accompanied by changes in undemocratic *dirigiste* institutions: the authoritarian, elitist, highly centralized, collusive and discretionary system of state-led development remained intact. The top-down strategic change was unilaterally imposed and did not lead to societal renewal or empowerment. The lack of organized or mobilized small business interests delimited the depth and impact of policy change. Korea's diseased or undemocratic *dirigisme* and the state's close link with its *chaebol* proxies demonstrated a persistent staying power.

Therefore, the first half of this article examines how undemocratic *dirigiste* institutions inhibited fuller expression of the changes in financial policy toward small business that came in the early 1980s. However, it does so from the standpoint of small businesses as they lived through them. Against such an institutional backdrop, the second half of the article sheds light on the little-known motivations, perceptions, and performances of small business people in Korea. In so doing, the article aims to offer a more nuanced account of the state of Korean small businesses. Hence, it first identifies and critically assesses three core historical-institutional aspects of top-down *dirigisme,* whose legacies have fettered SME development: unbalanced modernization, time-honored practices of financial institutions and big firms in dealing with SMEs, and the lack of viable grass-roots SME organizations.

The 1992 suicide of Koo Chun Soo, a respected 51-year-old owner of a small auto parts company, dramatized the problems. Koo's case made national headlines because he had won a prestigious government prize for his outstanding contribution to technological development. The country had had to import shock absorbers until Koo's Korea Gas Industry Co. successfully reproduced a gas-filled shock absorber in 1990 after investing two billion *won.* Koo committed suicide, however, after suffering from a serious cash flow problem and being unable to pay the interest or principal on five billion *won* that he borrowed to invest in technology R&D.[3] Koo's case illustrates the severe difficulties that one still faced in running a small company in Korea.

The Legacies of Statist Unbalanced Modernization

The credit rationing system arguably represented the *dirigiste* state's most powerful industrial policy tool. The way for any plan-rational state to establish a rationed capital allocation system was to maintain a low interest rate policy, just as Korea under Park had done except in the late 1960s. The state's low interest rate policy had the effect of killing two birds with one stone: stimulating investments for rapid industrial expansion and enabling the government to guide financial flow in the desired direction. Given the high inflation in Korea, officially set interest rates for general bank loans were close to zero or negative, way below the free market rates.[4]

Having access to the even cheaper export or National Investment Fund (NIF) loans constituted an immense source of wealth and an extraordinary opportunity from which politically well-connected *chaebol* benefited the most. The *chaebol* tended to borrow as much credit as they could, frequently in excess of what they needed for industrial investments. Given the considerably higher interest rates of unregulated curb market loans and skyrocketing real estate prices, it was not terribly surprising that excess borrowing in the form of highly subsidized policy loans repeatedly found its way into the curb market or into land speculation.[5]

Even though the low interest rate policy resulted in inefficient resource allocation, the state kept it in order to contain the cost of capital and effectively nurture strategic sectors, industries, or even particular firms. Since late catch-up industrialization through aggressive investment was paramount, the government resorted to foreign borrowing to fill in the large gap between domestic savings and investment demands, especially in the early stages of industrialization. Through guarantees, such as the system of bank guarantees that the government designed in 1962 for the repayment of foreign loans, the Korean borrower enjoyed assurances of support not only from the domestic banks but also from the central bank and the super ministry Economic Planning Board (EPB). The default risk for the lender was thus virtually eliminated: the government was expected to rescue a privileged firm, usually with fresh low-cost loans, if and when it verged on bankruptcy.

The regime decided who could have access to what funds and at what rate, and the banks simply followed government directives without independently evaluating the feasibility of any business undertaking. Under the circumstances, business success was crucially dependent on stable access to cheap capital (bank loans or foreign credits). In obtaining it, two things mattered: whether or not your business was strategically important, or if you had strong personal connections (*inmack* or *yonko*) through school, regional, or family ties to power holders. For instance, as long as a firm invested in projects targeted by the governing regime and was thus given preferential credits, its bankruptcy risk stayed practically nil – no matter how ambitious or risky the investment happened to be. The size of a company could also enhance its strategic importance, a factor that encouraged the *chaebol*'s extreme diversification into unrelated businesses. As one author puts it:

> the primary objective of enterprises was growth (or sales) maximization rather than profit maximization. The goal was for enterprises to grow at top speed to achieve a critical minimum size, at which the government would be unable to allow insolvency or bankruptcy. After all, widespread unemployment ignited by the failure of large corporations would cause social unrest and loss of reputation overseas for the Korean economy . . . Firms raced to the brink of bankruptcy with one eye ever fixed on the government, which played the role of referee in this game of brinkmanship.[6]

Indeed there were many instances of big firms getting bailed out of their financial crises, including the 9th largest *chaebol* Hyosung in the early 1980s, the 4th largest Daewoo in 1985 and again in 1989, and the Hanbo Housing Development, one of the three main subsidiaries that belonged to the 46th largest Hanbo in the early 1990s.[7]

Contrary to Amsden's argument, the "discipline" that the government imposed on the private sector was not universally applied.[8] Rent-seeking behavior was an inherent aspect of business in Korea, and maintaining close connections to key power holders proved to be the ultimate insurance. The top political leadership ultimately determined who among the umpteen entrepreneurs could have privileged and secure access to low-priced funds. The lack or loss of such connections explains the fall of Yulsan and Myongsong, the rising stars of the late 1970s and early 1980s, and the sudden collapse of the then 6th largest Kukje in 1985.[9]

Given the state's tight control of credit flows, SMEs with relatively low asset bases have been historically prone to bankruptcy, which remained a hot issue in society.[10] Korea's unbalanced modernization resulted in an abundance of petty firms and a dearth of healthy medium-sized corporations. Petty manufacturers with 5-19 regular employees made up 72 percent of all SMEs in 1995, while medium-sized firms with 50-299 employees constituted only nine percent in the same year.[11] The existence of huge pockets of petty enterprises fed the prevalent public perception of the plight of helpless small businesses.

The government has at times tried to provide specially crafted help for those small firms. The official definition of small business itself was revised in 1982 to distinguish petty firms from larger ones with more than 20 employees. However, without influential connections or competent personnel in a country where information rarely flowed freely, many of these petty and poorly equipped SMEs benefited little from the official promotional programs. Many programs designed to support SMEs never trickled down to the very bottom rung of the Korean political economy, where numerous firms struggled for survival.

President Park Chung Hee had been deeply concerned with nurturing SMEs, but the government's support and subsidies for small business produced hardly any quick and visible SME growth. The inability of SME programs to shore up the legitimacy of the military authoritarian regime placed the political leadership in a dilemma. Small businesses just seemed too numerous, too widespread geographically, and too diverse in needs for the government to engineer easy and glorious policy success. As President Park confronted the pressing task of generating immediate growth in an utterly underdeveloped economy, pursuing a balanced, SME-based modernization strategy looked neither politically compelling nor strategically feasible.[12] The dilemma was reflected in the adoption of the 1966 Small Business Basic Law and its result. The law could not have been enacted without Park's personal interest in SMEs. Yet the political imperative of executing unbalanced modernization turned the SME policy measures into empty words – advisory in nature and hence lacking enforcement teeth.[13]

Time-honored Practices of Financial Institutions

Another source of chronic SME trouble came from the historical pattern of interactions between small firms and financial institutions. First, because Korea suffered from an incessant shortage of industrial credits, banks continued with their traditional practice of demanding full collateral for loans. According to a classified internal report by the Ministry of Trade and Industry (MTI)'s SME bureau in 1993, more than 50 percent of bank loans to small business were made on the basis of collateral arrangements. Although the Credit Guarantee Fund extended 99 percent of its credit guarantees to small companies (a total of 7,160 billion *won* as of 1992), those much-needed guarantees covered only 17 percent of bank credits to SMEs.[14] Petty indigent SMEs with fewer than 20 employees, which are by definition destitute of collateral assets, have barely had any access to the industrial credits provided by financial intermediaries. Between 1980 and June 1990, a mere 3 percent of petty manufacturers with fewer than 20 employees secured any sort of SME policy funding. Even excluding those with fewer than five employees from the tally, the ratio of fund recipients among petty manufacturers amounted to only 13 percent.[15] From their disadvantaged standpoint, the continuity of financial hardship was overwhelming.

Second, as in Japan, Korean financial institutions kept effective interest rates high by demanding the redeposit of a certain portion of credit as "compensating balances" in the same institution that originated the credit. Such practices hurt small firms considerably more than big firms with political and financial muscle.[16] With the state's pronounced *chaebol* bias, financial institutions had no incentive to make numerous SME loans. Lending 1 billion *won* to a single company simply cost far less in administrative and transaction costs than lending 10 million *won* to 100 firms. The financial institutions were not free to charge higher interest rates, even if transaction costs were higher.

Consequent liquidity problems forced smaller businesses to scramble for unregulated, expensive curb market loans.[17] SMEs relied on the underground financial market for roughly 23 percent of their external funds. Bigger SMEs were progressively less dependent on underground funds, but for petty SMEs, nearly 37 percent of their funds came from the curb market. The most prevalent reason why SMEs used costly curb market funds was to augment operational funds (38 percent); lack of collateral and insufficient credit limits constituted 22 and 25 percent of the reason, respectively. The smaller the company, the greater trouble it had in supplying collateral or extending credit limits.

In times of economic downturn or liquidity crisis, the lending priorities of financial institutions became clearer. If a *chaebol* went bankrupt, its financial obligations were usually honored because the government would typically prod another *chaebol* with various incentives to take over the failing company. On the other hand, with a failing small business, it was entirely the lenders' responsibility to either collect any outstanding debts from the owner or suffer a financial loss. Particularly in recessions, financial institutions had a built-in disincentive to allocate scarce credits to SMEs. From a small business perspective, the financial institutions' practice was akin to "taking the umbrella away in the rain and giving it back in the sunshine."[18]

Third, there were some irregularities in the financial institutions' allocation of SME policy funds. At times, for example, firms of not quite small or medium size reportedly received bank credits by exploiting loopholes in the definition of small business. Also, some SMEs that were informally associated with or were de facto subsidiaries of *chaebol* drew from designated SME funds.[19] No systematic data existed to verify the extent to which such financial irregularities occurred in the process of credit rationing. As measured against the entire flow of funds, such illegal transactions might have been sporadic and isolated incidents. However, the existence of such practices aggravated the SMEs' troubled interactions with financial institutions.

The government's SME policy loans have shown impressive growth since the early 1980s. Compared with Japan, however, the increased credits seem inadequate for too many small and needy firms. By the late 1980s, for instance, Korea managed to funnel about 45 percent of bank loans to SMEs, but by then nearly 70 percent of the credits provided by Japanese financial institutions went to SMEs.[20] Moreover, Korea still falls short of supplying fiscal funds for non-collateral loans to petty SMEs. In contrast, Japan under the LDP has engaged in aggressive deficit spending for SMEs since the early 1970s. These government-funded, non-collateral loan programs for petty firms proved particularly successful both in mobilizing political support and in enhancing economic competitiveness.[21] In 1987, 178 billion *won* or 6.5 percent of the government budget for economic development went to SMEs in Korea, while 18 percent of Japan's almost incomparably larger budget pie was allocated to small business in 1985.[22]

Persistent Patterns of Big and Small Business Interaction

The gravity of institutionalized patterns of big and small business interaction can be readily appreciated by the fact that only about 30 percent of all small manufacturers in Korea were fully independent in the 1990s.[23] In other words, 70 percent of the country's small manufacturers depended in varying degrees upon big firms' purchasing power and oligopolistic market control to sell their parts, components, or semi-finished products. What made the small business dependency in Korea far more problematic was the fact that of all the small manufacturing suppliers, 80 percent depended on a single firm for more than 80 percent of their sales.[24] Small subcontracting firms' such an exclusive dependence on one big buyer firm proved costly and hazardous, as a result of which small firms became highly vulnerable to big contractors' unfair or exploitative trading practices. Three basic patterns of such historical interaction between big and small companies represented most frustrating and stifling for Korean SMEs: adverse terms of payment, big firms' "passing the buck" in hard times, and big firms' gobbling up SMEs even in industries where statutory restrictions remained in effect.

First, large firms typically required their small raw-materials buyers to pay in cash, while they purchased parts and components on credit from small suppliers.[25] Only 35 percent of payments to small subcontractors were made in cash, whereas the rest were made on credit.[26] Large firms issued promissory notes cashable usually far later than the statutory maximum of 60 days after the date of issue to small suppliers. About 85 percent of the promissory notes were still settled after more than 60 days as of the end of 1995.[27]

Second, particularly in hard times big firms heavy-handedly cut their payments for parts supplied by small firms.[28] Furthermore, big firms frequently paid SMEs in kind: they either gave out company gift certificates or their own products.[29] Clearly, such cost-saving measures provided big contractors a convenient cushion against market fluctuations, but they cut down their small suppliers' profit margins and thereby wages and other benefits which could possibly have gone to the frequently weak and non-unionized workers in the suppliers. Unfortunately, such unfair trading practices were fairly widespread, unless the subcontractors enjoyed privileged status through family ties or other significant social connections. For example, the success of Apollo as an auto parts company stemmed in part from the fact that the company's president is the first son-in-law to Chung Se Yung, the Hyundai founder's brother who headed the *chaebol* after a legendary career at Hyundai Motors.[30]

Third, big firms were notorious for their predatory expansion at the expense of small firms. Thanks to the augmented SME Business Coordination Act of 1982, which had barred the entry of large firms into industries set aside for SMEs, the more egregious cases of the top fifty *chaebol* entering off-limits production declined. However, other large firms persisted in violating regulations when they found it both feasible and lucrative, while the government was for the most part looking the other way.[31] A KFSB study found 169 cases of off-limits violations by big firms between 1984 and 1991.[32] Not surprisingly, the maximum penalty for such violations remained a one-year prison term *or* a mere 30 million *won* (about $37,500).

It should be noted that some recent changes have become observable in the patterns of relational abuse. Along with the government's policy shift, corporations began to realize that what critically differentiated the competitiveness of Japanese products from that of Korea's was not necessarily assembly technology, but the quality of parts and components. Thus some big firms started to establish new, collaborative, and mutually beneficial divisions of labor with their small suppliers.[33] By providing management skills and marketing networks, for example, LG and Hyundai helped various small exporters to focus on making incremental innovations in products and production technology.[34] Samsung Electronics built a good reputation for having developed 84 key component-making technologies in conjunction with 24 of its small subcontractors.[35] E-Land Corporation, a discount apparel maker and distributor whose sales grew to 500 billion *won* in 13 years, attributed its success to the sound and cooperative relations that it enjoyed with subcontractors and franchise retail stores.[36] Most notably, E-Land paid all its small suppliers (about 400 companies) in cash. Such cases seem to be increasing, although still in the minority. Of all technological developments made by Korean SMEs, for instance, less than five percent were accomplished through collaborative R&D efforts with big firms.[37] Cash payments to small suppliers remained a rare, if exemplary, exception rather than a rule.

The Lack of Viable Grass-Roots SME Organizations

The rapid development decades left small firms out in the cold. Devoid of strong membership, SME organizations suffered from lack of resources, representation, and political clout. The number of SME associations stagnated in the 1970s after a gradual increase in the 1960s. After renewed encouragement and support from the early 1980s, the number grew quite impressively.[38] To this day, however, the organizational strength and cohesion of SME associations remains pathetically weak. KFSB, the official organization with supposedly the best access to the state for promoting small business interests, fell far short as a focal point for interest aggregation, articulation or representation. Only about 40 SME associations, less than 10 percent of the registered total, regularly paid their membership dues. Moreover, even for dues-paying associations, their main motivation for registering with the KFSB was to access government programs such as exclusive procurement from small manufacturers.[39] Naturally, the weak and fragmented SME sector had little influence over government policies.

Such lack of viable grass roots SME associations for bottom-up policy feedback on one hand, and top-down militaristic policymaking on the other, eventually limited the depth of policy change and the impact of implementation. The initiation of reform was not the problem. The predominance of centralized executive authority unchallenged by political and social forces could ensure the efficiency of the reform process, no matter how wrenching it might be. Thanks to the heavily lopsided distribution of power favoring the presidency, Korea's ruling regime has by and large ruled by decree, often abruptly making major policy changes at battle speed. In fact, the Chun Doo Hwan regime initiated and executed the so-called Promising SME (*Yumang Chungsokiop*) Program, the centerpiece of its small business promotion policy, in the early 1980s without needing to build consensus or compromise with the National Assembly.

In September 1980, right after Chun became president, he issued a presidential decree concerning the *yumang chungsokiop* program.[40] According to my interviews, Kim Jae Ik, then presidential economic advisor, and Suh Suk Joon, then MTI minister, were chiefly responsible for persuading the president to issue the decree. The initial goal was to find and nurture 1,000 "promising" SMEs over the first three-year period. The selection for the prestigious program was made among small manufacturing (or manufacturing-related service sector) firms with fewer than 150 regular employees. The criteria included: possession of high technologies, patents, or technology-intensive products; specialty in products that the government's subcontracting promotion policy designated exclusively for SMEs; and commitment to quality and product innovation as well as plant automation. The Chun regime ensured that the selected SMEs were properly funded through privileged access to low-cost policy loans. In case a "promising" company verged on bankruptcy, the political authorities were even said to have threatened to make the financial institutions responsible for not supplying enough funds.[41]

Ostensibly, the reason why the Chun regime resorted to a presidential decree to institute the SME program was because it took less time and energy than legislating a new bill, which could potentially have conflicted with existing laws. Presidential decrees carried an almost extra-legal authority and thus could override other laws and statutes.[42] However, such top-down policy changes ultimately proved counter-productive. This centralized problem-solving hindered bottom-up voluntarism, frustrated more flexible mid- and local-level initiatives, and caused the body politic to degenerate.[43] The effectiveness of government officials in policy implementation, in particular, frequently depended on pressure from the top. Once the impetus from above weakened, no policy or program could be thoroughly implemented. Such was the fate that befell the *yumang chungsokiop* policy. After October 1983 when Kim Jae Ik and Suh Suk Joon, the two principal architects and driving forces of the policy, died in a terrorist attack in Rangoon, the SMEs selected under the program ceased enjoying all-out government support. The program for developing promising SMEs continued, but only in a watered-down version without much of its initial dynamism.

Lacking associational strength and cohesion, SMEs remained at the mercy of often whimsical government policies and bureaucratic authority. For instance, from establishing a company as a legal entity to physically constructing a factory building and starting its operation, one had to obtain literally hundreds of regulatory approvals, permissions, inspections, and licenses. In 1981, 1,887 – or 39 percent – of all civil affairs regulations belonged to the category of permits and licenses.[44] As a result, the secret funds hoarded by the nation's private firms for the purpose of paying various "express fees" or, at higher levels, "political contributions" to obtain licenses, expedite permits, etc. amounted to 1.8 trillion *won* in 1996, about 5 to 7 percent of the country's underground economy. When calculated against each industry's sales, not surprisingly, the construction industry's slush fund ratio topped all others. The average ratio for the construction industry recorded 1.6 percent; 1.3 percent for the transportation, storage, and communication industries; 1.1 percent for the manufacturing industry; and 0.9 percent for the financial, insurance, and real estate industries.[45]

The disastrous effects of this reality were openly revealed in the investigations into the June 29, 1995 collapse of Sampoong Department Store in Seoul, showing that the complicated top-down control system contained the seeds of its own demise.[46] The worst man-made disaster in the nation's history stemmed from shoddy, corruption-ridden construction work and lack of proper regulatory enforcement. Construction jobs were often subcontracted more than a half dozen times, ending up with petty SMEs that could not afford to follow costly safety measures. More troublesome was the fact that lower-level bureaucrats in charge of conducting inspections and issuing permits were rarely rotated – an open invitation to corruption. The corruption of lower-level civil service officials at different localities – taking bribes and glossing over blatant regulatory violations – made conspicuous the failure of top-down statism.[47]

Slush fund expenses constituted a disproportionately larger burden on small firms than on big ones with deep pockets. According to a detailed "bribe diary" kept by a blue jean dyeing company with six employees, which made the front pages of *Chosun Ilbo* on September 19, 1999, annual quasi-tax expenses totaled almost 5 percent of the petty firm's annual sales figure of 100 million *won.* A petty firm like this could become an easy target of corruption by lower-level government officials because of its usually inadequate wastewater processing facility, less-than-satisfactory fire safety equipment or preparedness, or chronic vulnerability to tax evasion charges. For instance, the district's environment protection bureau officials were required to inspect the company site once a year; in fact they visited five to six times a year and collected 200,000-300,000 *won* per visit in return for ignoring the pollution. The same corruption basically happened with regards to firefighters, district tax officials, and even some reporters.

Taxation was no less troubling a concern. According to a *Maeil Kyongje* survey of 2,200 small firms concerning their opinions about the tax administration, virtually no firm was happy with its manner of operation. Forty-five percent of the responding firms identified the key problem as the fact that the National Tax Administration was concerned only with collecting the targeted amount of tax revenues, 23 percent singled out the tax agency's unfair tax levying, 18 percent felt that the tax administration remained improperly managed and inefficiently run, and 11 percent pointed at the problem of inconsistency in the tax officials' application of laws.[48]

It is true that the nation's tax system favored producers, big and small, at the expense of consumers. Due to the biased distribution of a tax burden designed to promote aggressive investment and rapid industrial expansion, big firms benefited much more than small ones. But small business owners certainly did better than employees, workers, or average consumers.[49] The government exempted petty businesses with less than 48 million *won* in annual sales from the ten percent value-added tax, and it only applied a 1.3 to 4.3 percent reduced tax rate when levying value-added tax on those small firms whose annual sales fell between 48 million and 150 million *won*.[50] Although the official tax rates for corporate income were quite high (20 percent for the first 50 million *won* of the annual net income and 33 percent thereafter),[51] tax officials never fully enforced the tax codes. No systematic data are available, but it was an open secret that without tax evasion, small businesses would have owed the government at least 150 percent more than what they actually paid every year.[52] Particularly because small businesses with less than 150 million *won* in annual sales were not required to document receipts or other business transactions, it provided a built-in incentive for them to engage in undocumented transactions, underreport their sales, and cheat on taxes.

How does one, then, account for the widespread discontent among small business people toward the tax system? The answer lies primarily in the way the state's tax-collecting officials and small business people have interacted with each other. Every business is required to file its annual income tax return by February of the following year. Tax officials then audit "suspected" businesses or those of "random" choosing.[53] In typical tax inspections, the officials set in their minds a target amount for tax collection, but actually impose a far higher sum on the firm. If the target collection amount were 48 million *won,* for instance, they would levy 120 million *won.* Because it is difficult for firms under tax investigation to obtain fresh loans, it is often in their best interest to put an end to the business-stifling process as quickly as possible. The audited enterprises cut deals with collection officials (usually around the tax agency's original collection target), "treat the officials well," and then return to business.[54]

This trend in tax audits is on a decline. As of 1991, 97 percent of small businesses filed income tax returns, and the tax administration audited 17 percent of the returns.[55] The specter of going through such an ordeal on an annual basis, however, has left small business with an acute sense of inequity and distrust. Apart from being unhappily engaged in tax evasion activities, smaller businesses do not have much to gain from the tax system. An inverse relationship exists between the size of the firm and the tax subsidy utilization ratio. As of 1992, for instance, 89 percent of petty SMEs never used or made only limited use of the government's tax subsidization programs. Those firms with 20 to 49 regular employees did not fare much better, as their figure remained at 78 percent. This, undoubtedly, had something to do with the fact that smaller businesses generally earned less income and had fewer taxes to pay in the first place. More important, however, smaller companies lacked the information and personnel resources to tap the tax subsidy programs.

The Limitations of Top-down Policy

Korea's authoritarian *dirigisme* and its pursuit of an egregiously unbalanced modernization entailed a highly discretionary system of resource allocation that benefited a small number of large firms at the expense of the multitude of small businesses. The elitist, centralized system operated at the whim of state power holders, and the exclusionary circle of the privileged and powerful largely left the everyday concerns of small business operators out in the cold. Although the ruling regime under Chun engineered an unexpected policy change in favor of SMEs in the early 1980s, its effort to offset the socio-economic consequences of the *chaebol*-oriented modernization of the previous decades failed to break loose from historical-institutional constraints. Promoting small business by switching to another top-down *dirigiste* approach had its limits. It was obviously more difficult, and hence less desirable, for the highly centralized state to work effectively and flexibly with numerous SMEs all over the country than with a select few *chaebol.* But the more critical limitations stemmed from the nation's undemocratic *dirigisme* and its entangling fetters. Particularly ominous was the exclusionary, disempowering state policymaking mechanism and the consequent lack of viable grassroots SME organizations. Without the presence of empowered, participatory societal organizations that could collectively voice the concerns of small business people, the nation's undemocratic *dirigisme* and thus the roots of the state's collusive nexus with its *chaebol* proxies persisted, and so did chronic difficulties of small business operation under diseased *dirigisme*. President Chun was not a visionary leader with any genuine sense of mission to correct the wrongs of the past for the sake of national reconciliation and regeneration, which compounded such limits to top-down *dirigiste* reform. As observed in the case of the *yumang chungsokiop* policy, Chun continued the program for its political utility after the death of the two key figures responsible for its initial success and promise, but without the enthusiasm, dedication, or socio-political commitment that he once had appeared to have for small business.

Recasting Small Business in Korea[56]

The conventional image of Korean small business in the academic literature is one of a traditional, backward, and helplessly exploited part of a dual economic structure.[57] Clearly, the Korean *dirigiste* state's pronounced financial policy bias toward its *chaebol* proxies during the 1960s and 1970s had a major effect. While harsh and unsupportive policies caused disproportionate suffering for the nation's small business people, however, some of these relatively marginalized actors nevertheless proved resilient, adaptable, and incrementally innovative. Therefore, a balanced view of the past and a vision for the future requires a closer look at how small business people coped with adversity, despite the policies of the government, and how a few have even managed to thrive.

The hungry spirit of the first generation of business owners in the aftermath of independence from Japanese colonial rule made them tough and dedicated entrepreneurs. The industries and areas of business engaged in by small entrepreneurs were often considered inefficient pockets of the economy, but like wild grass, they took root in these pockets and created value-added and increased efficiency, even if on a small scale, making the most of their opportunities. When financial policy became less unfavorable toward small business in the 1980s, the composition of small business started to change. Largely unnoticed, second-generation small entrepreneurs capitalizing on technology-driven niche market strategies began to spring up. While big business is generally seen as the foundation of the "Korean miracle" of economic development, small firms, both old and new, were also a part of the miracle.

As of the early 1990s, petty businesses with 1-19 regular employees comprised nearly 82 percent of all SMEs, yet they accounted for less than nine percent of aggregate sales and of value-added by small manufacturers.[58] Given that not all of the petty firms could be venture start-ups or leading medium-sized firms of tomorrow, one might argue that the general picture of SMEs in Korea remains petty, backward, and far from modern. However, some of the evidence suggests otherwise, and challenges the conventional view of small business even in the nation's more traditional industrial sectors.

As of 1996, 65 percent of Korean small businesses were headed and managed by owner-managers.[59] The dominant presence of owner-managers and their control of company management as well as the relative scarcity of professional managers are frequently construed as indicators of pre-modern, backward, and anti-progressive elements in the small firms. Yet the tenacity, agility, hard work, and creativity of owner-managers comprised the very source of SME strength and innovation. Such merits contrasted with large firm professional managers who suffered from "big business syndrome", such as cumbersome, bureaucratic decision-making and consequent loss of vitality or flexibility in an otherwise formidable and resource-rich entity.

Most *chaebol* owners also shared humble beginnings as tough small entrepreneurs at liberation from Japanese colonial rule. Korea's utter economic backwardness led to a system of state-led economic development, and without the existence of *pouvoirs intermediaires*, the plebiscitarian practice in obtaining access to state power was rampant in the country.[60] Obviously, not every entrepreneur could gain access to or benefit from the *dirigiste* state. Under Korean *dirigisme*, the so-called *inmack* or personal connection to the state played a critical role in determining the success of big business enterprises, the kind that ultimately distinguished those firms that grew to behemoth size from those that did not, due to lack of access to the means of growth.

For example, without Chung Ju Yung's clever exploitation of his *inmack* to the state, nothing can fully explain the tycoon's success in turning his little automobile-repair shop opened in 1946 into the Hyundai conglomerate of today. The company's initial capital was accumulated through Chung's younger brother, Chung In Yung, who used his fluent English to obtain lucrative construction contracts from the U.S. military command in Korea. Chung then solidified the firm's dominant position by winning President Park's personal confidence and favor: Chung became the president's most trusted agent for executing many of the regime's most ambitious investment projects, such as the Seoul-Pusan Expressway and the world's biggest shipyard in Ulsan.[61]

In another example, without considering how Kim Woo Choong took advantage of his personal ties to state power holders, one cannot fully account for the Daewoo group's meteoric rise from a tiny textile-exporting company in 1967 to one of the top *chaebol* in less than a few decades. That Chairman Kim's father had been a respected teacher of Park Chung Hee in his Taegu High School years was a significant factor in making the younger Kim a personal favorite of the former president. Moreover, Kim, himself a graduate of the elite Kyongki High School, could tap prestigious Kyongki connections. Kyongki graduates dominated the group's high-level management positions. Cashing in on this personal network, Kim's Daewoo recorded the fastest growth rate among all Korean firms in the 1970s. During that frenzied development decade, the group engaged in a series of cheap debt-financed investment sprees into heavy industries and general trading, taking over many bankrupt or mismanaged firms – following the president's wishes, of course. In return for lucrative monopolistic or oligopolistic investment licenses, huge tax breaks, and privileged access to bank credits, the business entrepreneur generously contributed to the regime coffers.[62]

Interestingly, Vincent Brant's anthropological case studies of small enterprises in Korea corroborates the view that the nation's small business owners were not necessarily less entrepreneurial than big business, but simply lacked comparable connections to powerful figures.[63] In diseased *dirigisme*, what critically distinguished *chaebol* entrepreneurs from ordinary small business people was access to extremely profitable monopolistic product markets and government-subsidized loans and bail-out funds. Such access was determined not by managerial competence or foresight, but by intimate links to state power holders.[64]

Those less connected had proportionately less access to various lucrative domestic markets, government contracts, procurement orders, and bank loans. Their relative deprivation was particularly severe during the 1960s and 1970s, a period that crowned the principal-proxy nexus between state and *chaebol* and showed an increasingly pronounced financial policy bias in favor of *chaebol*. Thus, sustaining the level of small business activity was in itself a feat in such an environment. The development of small business over time was reflected in the relative decline of big business share in Korea's manufacturing value-added.[65]

The areas of business that SMEs could engage in had to be less capital-intensive, more subsistence-driven, and thus less efficient than those of larger enterprises. But first-generation small business people were no less tough, devoted, hard working, and ready to take risks and seize business opportunities. They were willing to work endless hours for even a modicum of return and bear many privations to make something of their small businesses. Given the vivid memory in the people's mind that even the nation's top *chaebol* had started from scratch only a generation ago, the sentiment that "anybody can do just about anything" still prevailed. The nation's low development level and its backward and inefficient small industries also meant that much room existed for small entrepreneurs to make relatively easy efficiency and productivity gains. It was in such sectoral pockets of inefficiency that they took root, incrementally increasing efficiency and contributing to the nation's development.

As Korea's financial policies began to discriminate less against SMEs in the early 1980s, the fabric of small business also changed. For instance, those with college and white-collar backgrounds replaced those with less educated, blue-collar backgrounds as the more prominent small business founders. As a vestige of the traditional Confucian social structure, the best and the brightest had flocked to the civil service, legal profession, or academia. When Korea's successful modernization broke that spell, top college graduates entered business, but they preferred the prestigious career of progressing up a *chaebol.* However, some discernible changes were in the offing by the 1990s, with more and more technological and managerial talent opting to establish independent, niche market-oriented enterprises, if not venture start-ups, rather than becoming the "organizational man" of a large firm. In more traditional industrial sectors as well, old small livelihoods evolved into new enterprises, or faced elimination by more modern, innovative, and light-weight players.

Let me illustrate this evolution by examining the development of one of Korea's oldest traditional markets – called Dongdaemun or East Gate. The origins of Dongdaemun Market may be traced back to 1905, when it started as a "modern" market called Kwangjang, specializing in textiles.[66] After the devastation of the Korean War, street peddlers returned and converted military uniforms and blankets into clothes in the now renamed Peace Market. Dongdaemun Peace Market became a thriving national hub of clothes manufacturers and wholesalers in the 1960s, as a myriad of small sewing companies clustered around it to produce low-priced, relatively fashionable clothes. By the late 1990s, 27,000 little shops in Dongdaemun market, which owned or had ties with over 20,000 factories around the area, successfully transformed the place into one of the nation's hottest shopping and tourist attractions. Daily business transactions exceeded ten billion *won*, and informal exports alone made by domestic and foreign suitcase traders amounted to $1 billion per year.[67]

The secret to success was clustering, or sectoral and geographical concentration of enterprises.[68] Because the key problem of many SMEs was not necessarily their size but their isolation, as Sengenberger and Pyke point out,[69] clustering facilitated key developments: specialization and division of labor; provision of customized machinery, spare parts, and just-in-time delivery of raw materials; the pooling of skilled workers and provision of speedy services in finances and fashion design; plus a mixture of intense rivalry among themselves and cooperation especially vis-a-vis other contending markets. In the crucible of cluster, only those merchants and clothes makers who successfully competed for customers and orders survived. Given the close proximity and collaboration among raw materials suppliers, clothes designers, producers and subcontractors, in fact, it took only a couple of days to produce, say, a modified version of an outfit once coming into contact with the idea from any of the world's top fashion shows.[70] Dongdaemun falls far short of leading global fashion, but it stays hot on the trail. With modern shopping malls, formally educated fashion designers, younger entrepreneurs, and former *chaebol* employees partaking of the cluster, whether Dongdaemun market will further evolve into a world-class pioneer in quality, design, and name brands is a test case of just how far SMEs will continue on their growth trajectory as the economy further opens space for them.

For Korea's clothes manufacturing and distribution industry, in any event, the Dongdaemun cluster certainly became a pioneer and benchmark. However, the concept of industrial districts was not new to other industries, as the origins of some of them could be traced as far back as the export-led industrialization drive of the 1960s. As of 1996, there existed 28 national industrial districts, 150 provincial industrial districts, and 19 other industrial districts. They remained far from all being equally successful or highly innovative, but their combined total employment and production amounted to 925,070 persons and 171 trillion *won,* or over one-third of the nation's manufacturing employment and almost one-half of manufacturing production, respectively.[71]

Korea's New Small Business

Another area worth watching concerns the nation's new or second-generation SMEs, including venture firms, which along with more traditional SMEs have grown immensely in more recent years. These second-generation small firms may offer the key to Korea's ongoing economic revitalization in the aftermath of the 1997 financial crisis as well as providing a way to catch up for the segment of the society that was "left out" during the heyday of the HCI push.

In the wake of the crisis the *chaebol* no longer seemed so grand. *Chaebol* owners' autocratic management style, excessive diversification, poor investments, and collusion with the state were all fingered as the culprit. Daewoo, then the second largest *chaebol,* collapsed, the majority of the top 30 *chaebol* groups disintegrated, and even big commercial banks had to be bailed out with taxpayer money. As the "too big to fail" myth about top *chaebol* was shattered, so were the virtues of rapid diversification and market share maximization. It is thus worthwhile to take a detailed look at some of the more successful SMEs in order to garner what lessons can be gleaned – in the hope of replicating and expanding such successes.

In fact, SMEs that focused on R&D and technology-driven quality, niche market specialization, productivity, and profit rose to new heights. Instead of *chaebol* owners or chairmen, the small but world-leading makers of tents, motorcycle helmets, nail clippers, and ultrasound systems became honored guests at the Blue House.[72] Small business entrepreneurs solidified their product competitiveness and technological lead in specialized niche markets. As of the late 1990s, for example, Jinwoong controlled 65 percent of the U.S. market and 35 percent of the global market for tents, with annual sales of $400 million. Hongjin Crown, an unknown name in Korea, captured 40 percent of the motorcycle helmet market in the United States. Daesung Metal, a rather obscure maker of nail clippers in Korea, had a 40 percent share of the global market. Medison, a leading medical equipment company, was the world's top manufacturer of low and medium-priced ultrasound systems. Daeryung Precision made satellite video receivers (SVRs), and had a 25 percent share of the global market.[73]

Leading medium-sized companies acquired their current fame not only for the scarce foreign exchange their exports generated during the 1997 crisis, but also for the rather novel way they made big money: through stocks or foreign direct investment (FDI). One of the highly celebrated examples was Locus, a telecommunications equipment manufacturer. Founded in 1990 with only 10 million *won* by Kim Hyung-Soon, a former doctoral student in Columbia's business school, Locus became Korea's top maker of computer telephony integration (CTI) systems in 1996 and sold a 38 percent share to Jardine Fleming Electra for $16 million in 1999.[74] Once Locus was listed in Kosdaq in November 1999, the company's market value reached 260 billion *won.* Even a traditionally labor-intensive manufacturer like Jinwoong, which never had equity or direct financing, made $50 million by offering a 90 percent share to Warburg Pincus in 1999.[75]

Star SMEs, however, were not born overnight in mid-crisis. Many of today's leading medium-sized companies got their start in the early 1980s when the government started to nurture a new generation of promising, technology-driven companies. These second-generation small business owners were better educated, usually with college degrees. Their business plans were based on technological innovation and niche market specialization, and more often than not, they anticipated eventually raising funds or making a good deal of money in the stock market, at a time when a listing in the market seemed a long shot for small firms.

Daeryung Precision's founder, Lee Hoon, proved representative of the new cohort of SMEs.[76] Lee, a son of a small business owner, had majored in applied physics at Seoul National University (SNU) and obtained an MBA from Columbia University. In 1982, at the age of 34, Lee started Daeryung Precision, an export, technology, and niche market-oriented SVRs manufacturer. Of the seven founding members, five were engineers engaged in research and development. Having started out as a small original equipment manufacturer for various North American companies, Daeryung had its ups and downs. Lee, however, believed that a technology-based niche market strategy would be particularly rewarding with the growth of the capital market in the future. Accordingly, he distributed 30 percent of stock shares to his six employees, and thereby sealed the bond among the founding members. The company was successfully listed in the stock market in June 1989. By 1998, Daeryung had 223 employees and earned 217 billion *won* in sales and 1.7 billion in profits. It enjoyed a 50 percent market share in North America, 25 percent in Europe, and 20 percent in the rest of the SVRs market.

Mirae Industry, a semiconductor equipment manufacturer founded in 1983, is probably one of the most popular examples of new SMEs in Korea.[77] Founder Chung Moon-Sool was 43 when forced to resign his post at the KCIA in the aftermath of the military coup on December 12, 1980. Figuring that "no late starter can become a *chaebol* in Korea without resorting to corruption, personal favoritism, or speculation,"[78] Chung determined he would make products with a technological edge in an area of business where others were not engaged. In the rough process of trial and error, he went bankrupt in 1985 and seriously contemplated taking his own life. A "born-again debtor" entrepreneur, Chung then spent the next ten years successfully producing test handlers for semiconductor products, eventually listing his company on the stock market in 1996 and paying off all his debts. With over 35 percent of 300 employees working in research and development as of 1998, Mirae made an annual profit of 5 billion *won* from 17 billion in sales. Chung received the highest managerial award from the Korean Employers' Association along with two *chaebol* CEOs in November 1998, an honor rarely given to a small business. Having invested $5 million in Lycos Korea Venture Fund, Chung became Korea's "godfather" of venture business.

The rise of innovative, second-generation SMEs did not only occur in high tech industries, but in more traditional ones as well. Jinwoong represented such an example.[79] Lee Yun-Jae, a Yonsei University graduate, had started Jinwoong in 1979 to make higher quality, higher value-added tents. The challenge came in the 1990s when Korea's labor-intensive industries lost price competitiveness to Chinese and Southeast Asian manufacturers. Exploiting the trend of globalization to overcome financial and other limitations under *dirigisme*, however, Jinwoong adopted a two-pronged strategy: while attracting FDI and perfecting state-of-the-art technology and high value-added production at home, it shifted low-end production to less developed countries. By 1998 Jinwoong had 81 employees in Korea and 84 employees abroad.

Bumwoo is another small business that flexibly adapted to the changing environment in a traditional industrial sector.[80] Originally established in 1981 as a motorcycle parts company with 16 employees in Chinju (located in the South Kyongsang province), by 1994 Bumwoo had developed into a respectable auto parts company with 70 employees. Annually, Bumwoo showed over 30 percent growth in sales because of founder Lee Chum-Bum's determination to accumulate capital and technology, by doggedly specializing in certain engine and transmission parts like shafts and gears, and by making constant innovations in products and production processes. Since 1990, as a result of more rigorous quality control, ambitious investments in precision equipment, factory automation, and its own R&D lab producing domestic substitutes for various imported parts, the per capita value-added jumped from 16.1

million to 34.5 million *won,* and the defective product ratio decreased from 1.8 to 0.2 percent.

Some small firms joined the new wave by diversifying or transforming themselves into sunrise industries from declining traditional sectors, thereby creating new domestic markets and stimulating structural changes in the economy. A case in point is Youngbo Chemical, founded in December 1979 in Taejon, South Chungchong province by Lee Bong-Joo, who had been operating a coal mining company since the early 1970s.[81] Sensing the centrality of petroleum and the inadequate supply of petrochemical products like plastic gourds and vessels in Korea, Lee had been traveling through Germany and Japan to visit companies in related industries. Believing in the growth potential of polyolefin foam products in automobile and boxcar interiors as well as the construction materials market, Lee concluded licensing agreements with various Japanese firms including Furukawa Denzo, Hitachi, Toray, and Sekisui. Lee's flexibility in introducing new technologies and products from Japan, practicing customer-oriented marketing and management, and devoting an increasing share of sales to R&D (3.35 percent by 1998) paid off over time. By 1998, Youngbo with 238 employees enjoyed 75 percent of the domestic poly foam market, exported 38 percent of its output, and competed head-on with Japanese products. Youngbo recorded three billion *won* in profit out of 37 billion *won* in sales in 1998, about one-third less than what it made the previous year, but still a very decent performance in the wake of the nation's financial crisis.

Namyang Industry, created in 1980 in Pusan with 30 employees, was yet another SME that successfully ventured into new territory.[82] Park Yun-So's small business had been in construction materials production, but it could not thrive in the highly competitive, cyclical industry dominated by well-capitalized and powerful firms. His search for a new, small niche market landed on sea-borne fire-safety equipment. He luckily learned that Korea imported all its sea-borne fire-safety equipments, as manufacturing them required high technological standards and rigorous quality specifications. By sheer will and perseverance, Namyang overcame all obstacles and finally acquired stamps of approval from SOLAS (Safe of Life at Sea) and USDOT (US Department of Transportation) as well as KS (Korean Standard). With less than 100 employees it gained a 30 percent global market share by 1993, earning 20 billion *won* in domestic sales and $20 million in exports.

Thinking New about Korea's New Small Business

What distinguished the new generation of small business people from the old was better education, preference as well as capacity for technology-driven niche market businesses over traditional brick-and-mortar ones, and viewing the capital market as an alternative source of funding and profit. First, by 1983, almost half of small business owners received a college education or beyond.[83] Although no systematic data on the earlier period are available, educational attainment had improved remarkably by the 1980s over previous decades.[84]

Second, by 1995, Korea had caught up with Japan and the U.S. in terms of R&D spending as a percentage of GDP (almost three percent).[85] In particular, Korea's leading medium-sized businesses, which stood at the forefront of the new wave of "modern," creative and technology-oriented, flexible and innovative, adaptive and niche market-driven SMEs, invested at least, if not well over, three percent of their sales.[86] As a result, the number of independent in-house research centers operated by small firms jumped to 2,278 by 1997, up from 708 in 1991.[87] As demonstrated by the SME cases examined above, the three percent of sales spent on R&D often went a long way for small firms, as they tended to engage in a narrow range of businesses, exploit economies of scope, and focus R&D effort on specifically applicable technologies or concrete product innovation.

Third, Korea's second-generation small entrepreneurs sensed a bigger chance of realizing their dreams through the burgeoning capital market. Even with little capital, if they gained competitiveness in a niche market, the changing capital market would bring a tremendous boon to them in the otherwise *chaebol*-dominant economy. Such promises of future profits and employee stock options provided a strong incentive structure for small firms to invest in long-term business strategies and technology-based product innovation and market creation. By the 1990s, so-called small "venture" businesses had become a buzzword and a focal point in both public policy and private circles. Particularly noticeable was the growth of Korea's over-the-counter Kosdaq stock market for small and venture firms.[88]

Although high tech ventures in computers and digital telecommunications (34 percent of the total) constituted Kosdaq's top-flight companies, many other venture firms in more traditional sectors also flocked to Kosdaq.[89] The number of officially recognized venture companies jumped to over 10,000 by April 2001 from 5,000 at the end of 1999.[90] Many of these "venture" companies, especially internet-based ones, have yet to post solid operating profits. Also, according to a Bank of Korea report, household borrowing, which soared in 1999 by 19 trillion *won* from the previous year, was driven by frenzied stock market investment, raising concerns about the sustainability of Korea's "new economy."[91] The Kosdaq bubble did burst in April 2000 and has been undergoing an adjustment and stabilization process. Clearly, though, venture firms as well as leading medium-sized companies have become as important and indispensable as big business to the nation's industrial structure and competitiveness.

Conclusion, and Some Policy Implications

Korean SMEs have come a long way as sources of industrial power more important than heretofore credited. Korea's undemocratic *dirigisme* had largely slighted SMEs to the country's disadvantage. Although the government's policy bias against SMEs began to change in the early 1980s, its support of them remained less than fully-fledged. Despite tough socio-economic conditions, however, both the first and second generation small entrepreneurs strived to prove their self-worth as viable business enterprises and constantly – and increasingly over time – contributed to the incremental improvement of the nation's economy. The level of *chaebol* success itself may well have been unattainable without the success of many old and new SMEs, which not only supplied cheaper labor-based parts and components but also generated domestic demand for raw materials and products that *chaebol* produced. Had the nation's political leadership embraced more inclusive and democratic state-society relations, a far more vibrant, independent and balanced private sector would have been formed. The absence of democratic governance and an autonomous, healthy civil society under Korean *dirigisme* as a new basis for equitable and sustainable development proved particularly painful in the wake of the 1997 financial crisis.

The government's full commitment to small business promotion would surely be nice a way to help ordinary citizens not only to partake of a fairer share of the country's economic growth, but also to identify themselves as contributing and respected members of the society. Even with respect to what sort of industrial policy should support SMEs in an increasingly globalizing economy, it seems clear that helping to nurture more bottom-up clusters, industrial districts, and collaborative networks, rather than merely increasing top-down subsidies for individual firms, seems a more plausible and promising policy path, as the success of the Dongdaemun market illustrates. Of course, Dongdaemun is not the only successful cluster in Korea. Some of the existing and dynamically growing clusters include the fashion and apparel valley in Taegu, shoe-making district in Pusan, fiber optics and telecommunications industrial district in Kwangju, bio-industrial districts in South Cholla province, and Yangjae-Poi Valley for software and other venture businesses.

In all those national and provincial centers of job creation and value-added, small businesses have played an increasingly vital role, an evidence which provides a tentative basis for considering alternative, if more balanced, democratic and progressive, approaches to future development. Once viewed as the atavistic remains of a pre-modern society, SMEs proved that they could be resilient, increasingly competitive, and capable of flexibly responding to changing markets and customer needs and demands. Once considered a nuisance or at best an object of social welfare, not a few SMEs now assumed the guise of ventures or specialized, niche market companies often at the cutting edge of the nation's technological and managerial development.

Endnotes

[1] Korea means South Korea, unless otherwise noted.

[2] See Hun Joo Park, "Small Business in Korea, Japan, and Taiwan: *Dirigiste* Coalition Politics and Financial Policies Compared," *Asian Survey,* Vol. 41, No. 5, (September/October 2001). The terms small businesses or small and medium enterprises (SMEs) used interchangeably in this article denote manufacturing enterprises with no more than 300 employees in Korea, albeit with some exceptions allowed since 1992 for labor-intensive industries. While the official definitions of small business of other countries even in the same Northeast Asian region are not exactly the same as Korea's, most of their statistical publications on SMEs are actually based on the number of a firm's regular employees, which make international comparison possible.

[3] *Chugan Maekyung,* December 23, 1992.

[4] The Bank of Korea (BOK), *Monthly Bulletin; Economic Statistics Yearbook*, (Seoul: BOK, various issues).

[5] In land speculation, the *chaebol* and other big capital owners have been suspected of extensively abusing their government connections and their privileged access to insider information on real estate development. See, for instance, *Wolgan Chosun*, June 1990, pp. 180-203; *FEER*, March 14, 1991, pp. 42-43.

[6] Pyung Joo Kim, "Korea's Financial Evolution, 1961-1986," in Jene Kwon, ed., *Korean Economic Development,* (N.Y.: Greenwood Press, 1990), p. 191.

[7] See *FEER*, July 21, 1983, pp. 74-75; April 2, 1992, pp. 62-63.

[8] Amsden, *Asia's Next Giant* (NY: Oxford University Press, 1989).

[9] The Yulsan industrial group, founded with 1 million *won* (about $2,000) in 1975, had $166 million worth of exports (mostly construction materials) by 1977. Its chairman, Shin Sun Ho, was then 29 years old. The group was heavily leveraged, with a debt-equity ratio of 27 to 1. In the face of a liquidity crisis in 1978, the group received some relief funding from its lead bank, the Seoul Bank under questionable circumstances. According to some reports at the time, it even exported rocks disguised as commodities to collect additional export loans. But in the end, the company's political connections turned out to be inadequate. In April 1979, Shin and the president of the Seoul Bank were arrested, the presidents of three other banks fired, and the group put into liquidation. See Shin Sang Min, "*Yulsangroup Tosaneui Ch'ungkyok*" [The Shocking Collapse of the Yulsan Group], *Shindonga*, May 1979; Park Moo, "*Chaebolkwa Kumyung*" [*Chaebol* and Finance], *Shindonga*, September 1981; *FEER*, April 27, May 11, 1979. Kim Dae Jung wrote that it was President Park's dislike of Shin Sun Ho that drove the group to bankruptcy. Kim Dae Jung, *Mass-Participatory Economy: A Democratic Alternative for Korea,* (Lanham, MD: University Press of America, 1985), p. 23.

Myongsong was a rather small apartment builder with paid-in capital of 82 million *won* in 1978, but by 1982 it controlled 20 subsidiaries with combined net sales of 25.5 billion won and paid-in capital of 6 billion *won.* The problem was that Chairman Kim Chol Ho exploited whatever personal links he had with people like Lee Kyu Tong, President Chun's father-in-law, to expand his business. But in the wake of the Chang Yong Ja scandal, which was also linked to the family of Chun's wife, Chun ordered the National Tax Administration to investigate the group, which led to its downfall in 1983. See *FEER,* September 8, 1983, pp. 56-58; Lee Chang Kyu, *Kyongjenun Tangsini*

Taet'ongryongiya [In Economics You are the President], (Seoul: Joongang Ilbosa, 1991).

The Kukje group was clearly a risk even by Korean standards, but there were other conglomerates like Hyosung and Daewoo, which borrowed no less than Kukje and yet survived. The liquidation and allocation of Kukje's subsidiaries were determined from above. By allowing Kukje to fall, Chun was warning big business about excessive borrowing and reckless management, but it was an open secret that Chun's choice of Kukje as a scapegoat came from his fury over the "deficient" political contributions of Yang Chung Mo, the chairman and son of the group's founder. See Yoo Young Eul, "Kukjegroupi Munojidonnal" [The Day the Kukje Group Collapsed], Shindonga, December 1987; FEER, August 22, 1985, p. 98-99; and Lee Chang Kyu, *Kyongjenun Tangsini Taet'ongryongiya.*

[10] Although the number of bankrupt firms in Korea continued to decline after the early 1980s, it tripled to 10,769 in 1992 from an annual average of 3,500 in the late 1980s. The number of bankruptcies stayed at 9,502 in 1993. MTI's classified internal reports, October 1994. See also Kim Dae Sik, *Chungsokiop Chiwonkumyung Chedowa Chongch'aekeui Munjejomkwa Kaesonpangan* [The Problems of and the Ways to Improve the Financial System and Policy for Small Business Support], (Seoul: The Small Business Research Institute, 1995).

[11] Korean Federation of Small Business (KFSB), *Chungsokiop Hyonhwang* [The Current State of Small Business], (Seoul: KFSB, various years).

[12] Oh Won Chul, *Hankukhyong Kyongje Konsol* [Economic Engineering Korean Style], (Seoul: Kia Economic Research Institute, 1995), pp. 51-52.

[13] Ibid., pp. 178-179.

[14] Interviews with officials at the Credit Guarantee Fund, summer 1993.

[15] Ibid.

[16] See *Maeil Kyongje,* May 17, 1995; February 25, 1992.

[17] The data for this paragraph come from KFSB, *Chungsokiop Kyongyong Silt'ae mit Tonghyang* [The State and Trend of Small Business Management], (Seoul: KFSB, 1996), p. 90.

[18] Interview with Park Chang Kyu, Chairman of Samae Ribbon Co., Seoul, Korea, June 11, 1996.

[19] KFSB, *Chungsokiopeui Kumyung Iyong Aero Silt'ae Punsok* [An Analysis of Practical Difficulties in SME Financing], (Seoul: KFSB, 1992). See also Korea Economic Research Institute, *Hankukkiopeui Chaemuhaengt'aewa Kumyungkwanhaenge taehan Yongu* [A Study of Korean Firms' Business Behavior and Financial Practices], (Seoul: KERI, 1992).

[20] MTI's classified SME Bureau records; Kim Dae Sik, *Chungsokiop Chiwonkumyung Chedowa Chongch'aekeui Munjejomkwa Kaesonpangan,* p. 4.

[21] Kent Calder, *Crisis and Compensation,* (Princeton: Princeton University Press, 1988), ch. 7.

[22] *Maeil Kyongje,* June 29, 1988.

[23] Independent SMEs produced finished products and sold them independently in the market.

[24] KFSB, *Chungsokiop Silt'ae Chonghap Tongkyejib* [The Comprehensive Statistics on the State of Small Business], (Seoul: KFSB, various years).

[25] *Maeil Kyongje,* May 20, 1995; May 20, 1993.

[26] KFSB, *Chungsokiop Kyongyong Silt'ae mit Tonghyang*, p. 28.
[27] Ibid., p. 29; FTC, *Fair Trade Act and Enforcement Decree*, (Seoul: FTC, 1993), p. 85.
[28] *Maeil Kyongje*, May 20, 1995.
[29] Interviews with a number of small business people, Seoul, summer 1996.
[30] *Maeil Kyongje*, May 20, 1993.
[31] For various cases of big firms' violations, see *Chugan Maekyung*, December 23, 1992; *Maeil Kyongje*, June 16, 20, 22, 1988; July 8, 11, 13, 14, 18, 20, 21, 22, 25, 27, 28, 29, 1988; August 8, 10, 13, 17, 18, 23, 25, 27, 29, 31, 1988; September 3, 5, 6, 8, 10, 15, 21, 28, 1988; October 3, 4, 8, 11, 1988; *Donga Ilbo*, January 19, 1984; May 22, 1984; August 4, 1984.
[32] *Maeil Kyongje*, March 5, 1992.
[33] Ibid., May 26, 1993; May 27, 1993; May 29, 1993.
[34] Ibid., May 25, 1993.
[35] Ibid., May 24, 1993.
[36] Ibid., May 22, 1993.
[37] Ibid., May 24, 1993.
[38] As of 1987, small firms that joined SME associations numbered 24,809 or less than 15 percent of the total. KFSB, *Kihyop Samsipnyonsa* [The Thirty-Year History of KFSB], (Seoul: KFSB, 1992), pp. 330-331.
[39] Interviews with Suh Jung Dae and Hong Soon-Yeong, Research Fellows at the Small Business Research Institute, KFSB, summer 1995.
[40] The following account draws heavily on my interviews with Kim Eun Sang, the president of KOTRA, on July 8, 1996, and Lee Won Gul, the director of the Aerospace Industry Division, Basic Industry Bureau at Ministry of Trade, Industry, and Energy on July 10, 1996. Kim Eun Sang was director general of the Small Business Bureau at MTI from 1980-1983, and Lee Won Gul was his assistant at the time. See also interviews with officials at the SME Promotion Corporation on June 25, 1996.
[41] Many SMEs which graduated from the *yumang chungsokiop* program became respectable medium-sized firms. The examples included Samhwa Printing, Co., Samcholli Bicycle, Co., Samick Musical Instrument, Kwangdong Pharmaceutical Co., Tongwon Industry, Donga Trading Co., Heungchang Mulsan, Susan Heavy Industry, and Kyungin Industry.
[42] Interestingly, the democratically elected Kim Young Sam government of the 1990s similarly issued a presidential decree to institute the Structural Adjustment Fund, a key piece of its own SME policy designed to promote small firms' factory automation, modernization, and technological innovation. By pooling fiscal and bank funds, it provided 1.4 trillion *won* in 1993, 500 billion *won* in 1994, 1 trillion *won* in 1995, and 1.5 trillion *won* in 1996 for the structural adjustment fund. My interviews with officials at the SME Promotion Corporation, June 25, 1996.
[43] See Chong-Min Park and Kim Byung-won, "*Hankuk Kukka Kwanryoeui Euisik*" [The Korean State Officials' Mindset], *Hankuk Haengjonghakpo* [The Korean Journal of Public Administration], 25:4, (February 1992).
[44] The figure reached 66 percent if it included not only permits and licenses but also regulatory reports and approvals. The Committee for Regulatory Reform, *Songjang Palchonul wihan Chedokaeson Paekso* [White Paper on Institutional Reform for Economic Growth and Development], (Seoul: 1982); quoted in Kim Chung Soo,

Chungsokiopeui Kyongyong Chonryak [Strategic Management of SMEs], (Seoul: Daehan Kumyung Kyongje Yonguso, 1993), p. 143.

45 *Naeway Kyongje,* June 14, 1996.

46 See *Hankuk Ilbo,* July 1, July 4, and July 5, 1995; B.C. Koh, "South Korea in 1995," *Asian Survey,* January 1996, pp. 56-57. The collapse of a 100 meter-long section of the five-story department store building killed more than 700 people and wounded 932.

47 Due to Korea's undemocratic, corrupt *dirigisme,* episodes of nation-jolting, man-made havoc like the one that wrecked Sampoong became common. The killing of 19 kindergarten children and four adults in a July 1999 fire in a summer camp dormitory in Hwasung County was just one incident. The facility had been licensed even though the dormitory was not the concrete-and-steel building described in county records, but a stack of shipping containers lined with flammable materials. It passed annual inspections despite a lack of sprinklers, functioning fire extinguishers, and entry roads for firefighters. See *The LA Times,* July 7, 1999.

48 *Maeil Kyongje,* May 8, 1995.

49 Korea taxed earned income more heavily than capital gains or interest and dividend incomes. Also, 55 percent of the nation's tax revenue came from indirect taxes in 1992, while in Japan the equivalent figure was only 26 percent in the same year. Such a regressive tax system was designed to squeeze savings out of lower-income taxpayers for faster capital accumulation. See The MOF, *Chose Kaeyo* [The Taxation Abstract], (Seoul: 1993).

50 *Seoul Kyongje,* June 26, 1999; *Maeil Kyongje,* January 4, 1999.

51 On top of that, one had to add surtaxes like the defense tax and the inhabitant tax. To be sure, the personal income tax rates were definitely higher. The maximum rate was 55 percent for taxable incomes in excess of 60 million *won* per year. Wan-Soon Kim and K.Y. Yun, "Fiscal Policy and Development in Korea," *World Development,* 16:1, (1988).

52 Interviews with a number of small business people in Seoul, Korea, summer 1996.

53 The National Tax Administration directly handles the tax accounts of those firms whose annual sales exceed 10 billion *won,* and the district tax offices oversee those of smaller businesses.

54 Interviews, Seoul, Korea, summer 1996.

55 The data for this paragraph come from KFSB, *Chungsokiopeui Sejewa Sejong Iyong mit Aero Silt'ae Punsok* [Analysis of the State of Small Business's Use and Difficulty in the Use of the Taxation System and Policy], (Seoul: KFSB, 1992).

56 The section that follows heavily draws on Hun Joo Park, "The Political Economy of Small Business in Korea," *Journal of Contemporary Asia,* Vol. 32, No. 1, (2002).

57 The dual industrial structure argument and its traditional image of exploited small business came most forcefully from Japan's Marxist political economists. Following in their footsteps, Lee Kyung-Eui became the biggest proponent of the Marxist paradigmatic perspective on small business in Korea. For more details on the perspective and literature, see his *Hankuk Chungsokiopeui Kujo* [The Structure of Korean Small Business], (Seoul: P'ulbit, 1991).

58 Kim Chung Soo, *Chungsokiopeui Kyongyong Chonryak,* p. 298.

59 KFSB, *Chungsokiop Silt'ae Chosa Pogoso,* (1996).

60 See Reinhard Bendix, *Nation-Building and Citizenship,* (Berkeley: University of California Press, 1977[1964]).

[61] See, for instance, Kim Yung Ho, *Kwankwon Kyongje T'ukhye Kyongje* [State-run Economy Preferential Economy], (Seoul: Chungam, 1989); Yoo In Hak, *Hankuk Chaeboleui Haebu* [An Anatomy of Korean *Chaebol*], (Seoul: P'ulbit, 1991).
[62] Ibid.
[63] Jones and Sakong, *Government, Business, and Entrepreneurship* (Cambridge: Harvard University Press, 1980), Appendix A. The public shared the view that big business grew big not simply through entrepreneurial and managerial talents, but also through connections with state power holders. In a newspaper survey, for instance, 66 percent of the people interviewed pointed to the chaebol's political connections as the cause of their success. *Ilyo Shinmun,* August 23, 1995, pp. 12-13.
[64] The persistence of this reality has critically limited the effectiveness of a variegated and otherwise radical array of corporate governance reform measures put in place in the wake of the 1997 financial crisis. The share of top chaebol owners' stock ownership has long been below ten percent on average, but the owners' autocratic control or management style has hardly been challenged. For instance, Lee Kun-Hee, current Samsung Chairman and a son of the company's founder, controls only five percent of Samsung Electronics while foreign investors control over 40 percent. Particularly after the abolition of mandatory tender offer and the legalization of hostile M&As after the crisis, a takeover of the much-coveted Samsung Electronics became a possibility. Yet such has yet to happen, not only because of a fear of possible loss of synergy effect that comes from being linked with other group subsidiaries, but also because the founder's son is supposed to enjoy better access to the state authorities.
[65] See Cha Dong-se and Kim Kwang-suk, eds., *Hankuk Kyongje Pansegi* [The Half Century of Korean Economy], (Seoul: KDI, 1995), p. 397.
[66] The following section on Dongdaemun Peace Market draws on Kim Yang-Hee and Koo Bon-Kwan, "Chaerae Euiryusijangeui Puhwalkwa Sisajom" [The Resurrection of Traditional Clothing Market and Its Implication], Samsung Economic Research Institute, (October 1999), and my interviews.
[67] Dongdaemun market, together with Namdaemun (South Gate) market, handled 30 percent of the nation's wholesale transactions in clothing.
[68] On the vitality of small business clusters or industrial districts, see Piore and Sabel, *The Second Industrial Divide* (New York: Basic Books, 1984); David Friedman, *The Misunderstood Miracle,* (Ithaca: Cornell University Press, 1988); D.H. Whittaker, *Small Firms in the Japanese Economy* (Cambridge: Cambridge University Press, 1997); W. Sengenberger and F. Pyke, "Small Firm Industrial Districts and Local Economic Regeneration," *Labour and Society,* 16:1, (1991); Hubert Schmitz, "Collective efficiency: Growth path for small-scale industry," *The Journal of Development Studies,* (April 1995); John Humphrey and Hubert Schmitz, "The Triple C Approach to Local Industrial Policy," *World Development,* 24:12, (1996).
[69] Sengenberger and Pyke, "Small Firm Industrial Districts."
[70] It took several months for large, upscale department stores to design and produce a new line of clothing.
[71] See http://kicox.or.kr:9000; KFSB, *Chungsokiop Hyonhwang* (1998).
[72] *Financial Times,* internet version, March 10, 1999.
[73] Shin Hyun-Am and Kim Jae-Yun, "Kanghan Chungsokiopeso Paeunun Chihye" [Gaining Wisdom from Strong Small Business], CEO Information, Samsung Economic

Research Institute, (February 1999).

[74] See their website www.locus.co.kr; *Maeil Kyongje,* January 27, 1999; *Chosun Ilbo,* Sept. 3, 1999.

[75] *FEER*, July 29, 1999, pp. 36-37.

[76] My discussion of Daeryung Precision draws on Financial Supervisory Commission's (FSC) corporate data; Ban Byung-Gil, et al., *Hankookkiopeui Segyehwa Chonryak Saryeyongu* [Case Studies on Corporate Korea's Globalization Strategy], (Seoul: Shinwon, 1996); various media reports including *Hankook Kyongje,* August 1, 1997 and June 26, 1999; and my interview on October 25, 1999.

[77] The following section on Mirae draws on FSC's corporate data; Lee Chang-Woo, *Venture Management,* (in Korean), (Seoul: Maeil Kyongje, 1999); various media reports including *Shindonga,* (January 1998), *Hangyoreh,* April 26, 1999, and *Electronic Newspaper,* July 12, 1999.

[78] Quoted in *Hangyoreh,* April 26, 1999.

[79] The following draws on FSC corporate data; Ban, et al., *Hankookkiopeui Segyehwa Chonryak Saryeyongu*; various media reports including *Maeil Kyongje,* July 21, 1999 and *FEER,* July 29, 1999, pp. 36-37.

[80] This section on Bumwoo draws on Moon Woo-Sik et al., *Case Studies of Innovative SME Management,* (in Korean), (Seoul: KDI, 1994).

[81] The discussion on Youngbo draws on FSC's corporate data; *Maeil Kyongje,* December 22, 1997; and interview with Lee Bong-Joo on October 3, 1999.

[82] See Moon et al., *Case Studies of Innovative SME Management*.

[83] KFSB, *Chungsokiop Silt'ae Chosa Pogoso* [Survey Report on the State of SMEs], (various issues).

[84] As of 1944, for instance, the nation's college graduates had totaled 29,438 persons, or 0.1 percent of the population. The proportion of those with tertiary education impressively rose to five percent by 1955, 6.9 percent by 1965, 9.5 percent by 1975, 16 percent by 1980, 35.6 percent by 1985, and 54.6 percent by 1995. *Maeil Kyongje,* December 27, 1999; Noel McGinn, et al., *Education and Development in Korea,* (Cambridge: Harvard University Press, 1980); KEDI, *Educational Indicators in Korea,* (Seoul: KEDI, 1996).

[85] *OECD Science, Technology and Industry Scoreboard 1999*.

[86] See Shin and Kim, "Kanghan Chungsokiopeso Paeunun Chihye."

[87] KFSB, *Chungsokiop Hyonhwang,* (1998), p. 144.

[88] Thanks in part to the government's increased financial support, tax breaks, and relaxed listing requirements, Kosdaq recorded a phenomenal expansion in the second half of 1999. At year end, over two trillion won traded per day on Kosdaq, and its market valuation almost reached the 100 trillion won mark, nearly one-third of the big business-dominant Korea Stock Exchange. "The Pros and Cons of the Kosdaq Bubble Argument," (in Korean), www.cfe.org.

[89] The government launched a bold campaign to increase the number of venture companies to 40,000 by year 2005, employing 1.2 million people and representing 18 percent of GDP. *Seoul Kyongje,* January 12, 2000; *Joongang Ilbo,* January 14 and 26, 2000; *Maeil Kyongje,* January 20 and 31, 2000; FEER, February 3, 2000, pp. 38-40.

[90] *Joongang Ilbo,* April 17, 2001.

[91] Cited in *Chosun Ilbo,* January 31, 2000.

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