Developing Competitive SMEs in Korea

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SOME OBSERVATIONS ABOUT SMEs

1. They account for half of value added and nearly 80 percent of jobs.

2. Most competitive SMEs have developed through supplier networks with Chaebols.

3. Except those in Chaebol network, most others are in low value added activities, and in services, despite SME policies of 1980+

4. They are generally less productive than larger companies and most remain small over time... rate of informality high.

5. Only a small portion (1 percentile) grow and account for the bulk of value added and jobs.

6. Rate of business entry is low.

7. SMEs face different constraints compared to large firms or those in Chaebol network. Finance is among many constrained and sometimes not to most important one...
SMEs are predominantly involved in low-added activities across a large selection of industries.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Low Value Add</strong></td>
<td><strong>Medium Value Add</strong></td>
</tr>
<tr>
<td>Agriculture</td>
<td>Small-scale Farming, breeding</td>
</tr>
<tr>
<td>E&amp;E</td>
<td>Assembly, testing, packaging</td>
</tr>
<tr>
<td>Private Healthcare</td>
<td>Out-patient care, general practices, routine</td>
</tr>
<tr>
<td>Services</td>
<td>tests</td>
</tr>
<tr>
<td>ICT</td>
<td>Maintenance support, system integration</td>
</tr>
<tr>
<td>Education</td>
<td>Small-scale tuition, vocational training</td>
</tr>
<tr>
<td>Palm Oil</td>
<td>Production</td>
</tr>
<tr>
<td>Wholesales &amp; Retail</td>
<td>Groceries, non-outlets (e.g. vending machines), Small-scale F&amp;B outlets</td>
</tr>
<tr>
<td>Tourism</td>
<td>Budget transportation, accommodations, support (e.g. ticketing, booth contractors)</td>
</tr>
<tr>
<td>Financial Services</td>
<td>Financial Intermediaries (e.g. insurance agents, IPO distributors)</td>
</tr>
<tr>
<td>Business Services</td>
<td>Facility operations/management, surveying, small-scale M&amp;E engineering</td>
</tr>
<tr>
<td>Oil, Gas and Energy</td>
<td>Spare parts, installation</td>
</tr>
</tbody>
</table>

**Area of Concentration**
SME Productivity

- SME labor productivity below other countries
- Material share of informal sector in the economy

**SME Labour Productivity (US$’000)**

- **US**: 103
- **Denmark**: 93
- **Ireland**: 85
- **Japan**: 78
- **Sweden**: 76
- **Germany**: 65
- **Singapore**: 55
- **Italy**: 51
- **Korea**: 42
- **Malaysia**: 15

**Share of Informal Sector to GNI**

- **Korea**: 27.5%

Source: World Bank from various sources

Source: Schnider (2002)
Young and high growth firms are main contributors to gains in value added and employment

- New firms accounted for 90% of net job creation
- Top 1 percentile mfg firms accounted for:
  - 70% of additional GDP
  - 46% of new jobs created
- Top performers are in all sub-sectors

Change in Value Added 2000-2005

Change in Employment 2000-2005

Competitive sectors register more high growth firms

- Competition encourages firms to innovate and renew technologies

Source: World Bank based on Census of Establishments and Enterprises 2005, DOSM
The rate of business formation in Korea is robust, but lower than in high income countries.

Average Entry Density\(^1\) (2011)

1/ Entry density: no of newly registered over working age population

Source: Development Research Group, World Bank
Entrepreneurship attitudes influenced by low perceived capabilities and fear of failure

- High media attention but only 5% had intentions to start business

### Entrepreneurial Attitudes and Perceptions in Korea and Selected Countries

<table>
<thead>
<tr>
<th></th>
<th>Emerging markets (%)</th>
<th>Developed countries (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Malaysia  Brazil  China  Chile</td>
<td>Germany  Japan  Korea  UK  US</td>
</tr>
<tr>
<td>Media attention for entrepreneurship</td>
<td>88  81  77  46</td>
<td>49  59  61  52  68</td>
</tr>
<tr>
<td>High status to successful entrepreneurs</td>
<td>69  79  77  71</td>
<td>77  52  71  77  76</td>
</tr>
<tr>
<td>Entrepreneurship as a good career choice</td>
<td>56  78  70  87</td>
<td>53  28  68  51  65</td>
</tr>
<tr>
<td>Perceived opportunities</td>
<td>40  48  36  65</td>
<td>29  6  13  29  35</td>
</tr>
<tr>
<td>Perceived capabilities</td>
<td>24  58  42  66</td>
<td>42  14  29  52  60</td>
</tr>
<tr>
<td>Fear of failure</td>
<td>45  33  32  22</td>
<td>34  33  33  30  27</td>
</tr>
<tr>
<td>Entrepreneurial intentions</td>
<td>5  27  27  38</td>
<td>6  3  10  5  8</td>
</tr>
</tbody>
</table>

Source: Global Entrepreneurship Monitor, 2010
1. SME policy in the 1960s was one of protection and promoting SMEs within a vertical structure of large businesses. Following WTO and when Korean growth model was exposed to external shock of financial crises, SMEs viewed as source of job creation and growth.

2. Policies have shifted form protection in 1960s to competitiveness and promoting start ups and innovation.

3. Strategy should be evidence-based with a strong M&E component and flexible as realities change and outcomes are evaluated. (M&E built in)

4. SME strategy should be about facilitating entrepreneurship and enabling small firms to grow.

5. Governments try to through money at the problem. Too many Programs, impact and effectiveness hard to measure. Focus should be on addressing market/information imperfections.

6. Only a handful of high impact programs needed each led by a single agency... Another agency coordinates and monitors.
Guiding principles

The programs under the implementation plan are developed based on the following guiding principles are:

(a) demand driven,
(b) based strongly on public-private partnership, with SME programs owned by the government and delivered by the private sector,
(c) reduce budgetary burden by tackling market imperfections and information asymmetries, and thereby creating markets for SME service delivery,
(d) ease of monitoring and evaluation – Only six high-impact programs rather than 290!
(e) evidence-based (impact through M&E) and therefore subject to adjustment ("live Masterplan"), and (f) simultaneous implementation of the programs to reinforce each other.
Consistent with strategic direction of the government must deal with a market failure.

The support must deal with a market failure.

Serve as a catalyst for local markets and capacity for commercial service providers.

Avoid substituting public money for private money.

Involve Private sector in administration and delivery.

Results must be measurable and measured.

Must represent value for money.

Clear accountability for Programs.

Principles
Background on Malaysia SME Masterplan

“Transformation through reinvigorating the private sector”
“Bottom 40%”
“SMEs as the engine of growth and innovation”

SME MASTERPLAN 2011-2020
(SME Corp. & World Bank)

Phase 1
(Sep 2010 – Apr 2011)
• Current Status of SMEs;
• Key Performance Drivers and Factors Inhibiting Growth;
• Impact of Government Initiatives; and
• Moving Forward: Policies, Strategies and New SME Development Framework

Phase 2
(May 2011 – Sept 2011)
• Action Plans & Monitoring Mechanism
Current Status of SMEs

SME MASTERPLAN 2011-2020

- Low productivity of SMEs
- Business formation lower than high income countries
- Small no. of firms account for bulk of gains in GDP & employ
- Material share of informal sector

- Productive and competitive SMEs
- Intensify rate of business formation
- Increase number of high growth firms
- Intensify formalization
Six key Drivers of SME performance

Regression analysis showed:

• **Innovation and technology**: highest impact on TFP & employment growth

• **Skills, finance, market access** and to a lesser extent **infrastructure and regulations** also important on TFP, wages & employment growth.

• Impact differs by size of establishments

Source: World Bank based on Malaysia Productivity and Investment Climate Surveys (PICS) 2002 & 2007

**Critical to enhance all these drivers simultaneously as shortcomings from any one factor can weigh down on performance prospects**
Government initiatives

- SME development framework under NSDC has enhanced coordination across 16 ministries and 60 agencies
- RMK9: RM26 billion (11.6% of DE) spent on 500 programs
- In 2011, RM5.9 billion for 219 programs

Assessment
- Big programs were on financing
- Too many small programs
- Assistance mainly Government dependent
- Difficult to assess impact of programs due to lack of monitoring and evaluation (M&E)
New SME Development Framework for innovation-led and productivity-driven growth

**Vision**
Globally competitive SMEs across all sectors that enhance wealth creation and contribute to the social well-being

**SME Development Framework**

**Goals**
- Increase Business Formation
- Intensify Formalisation
- Raise Productivity
- Expand Number of High Growth Firms

**Focus Areas**
- Innovation & Technology
- Human Capital
- Market Access
- Legal & Regulatory Environment
- Infrastructure
- Access to Financing

**Institutional Support**
- Reliable Database
- Monitoring & Evaluation
- Effective Coordination
- Effective Business Services
Plan proposes **32 initiatives** across all focus areas to achieve the desired goals

<table>
<thead>
<tr>
<th>Focus Area</th>
<th>Formation</th>
<th>High Growth &amp; Innovative</th>
<th>Productivity</th>
<th>Formalisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innovation &amp; Technology</td>
<td>3</td>
<td>6</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Access to Finance</td>
<td>2</td>
<td>5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Human Capital Development</td>
<td>-</td>
<td>3</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>Market Access</td>
<td>1</td>
<td>7</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Legal and Regulatory Framework</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Infrastructure and Security</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10</strong></td>
<td><strong>24</strong></td>
<td><strong>18</strong></td>
<td><strong>4</strong></td>
</tr>
</tbody>
</table>
6 High Impact Programs complemented with other measures

- **6 High Impact Programmes (HIPs)**
- **1 agency** accountable for delivery, impact evaluation, coordination for each HIP
- **Centralized monitoring & evaluation**

**Macra measures**
- Completion of Integrated Trade Facilitation System
- Bankruptcy Law
- Taxation Policy
- Foreign worker policy
HIP 1: Integrate business registration & licensing to enhance ease of doing business

- Streamline and simplify procedures for opening new businesses
- Reduce costs and time taken to start a business
- Encourage formalization

Context

- Single window & ID for whole of Government
- Business registration as pre-requisite for licensing

Diagram:

- National Business Registration system (MyCoID)
- National Business Licensing System (BLESS)
- National Single Business Licensing and Registration system
Existing financing to SMEs mainly bank-based

Current scenario

- ~ 80% SME financing by Banks
- Limited non-banking financing
- VC industry total committed funds grew yoy 11% to RM5.96 billion
- 51% public funded

Existing Initiatives

Contribution of VCs to SME financing outstanding

- 2%

No. of VC Investment firms

- 113

Further Support

- Increase size of non-banking financing, including attracting institutional funds
- Increase vibrancy in VC industry
- Structured financing
HIP 2: SME Investment Programme (SIP) to provide early stage financing

**Context**
- Limited avenues for **early stage financing**
- VC industry lacks vibrancy; highly dependent on public funds (51%)

**Private Investors**
- Government Loan through SIP
  - Govt. provide long term capital into licensed investment companies
  - Investment companies to provide debt, equity or hybrid investments in most promising SMEs

**Investment Companies**
- Debt
- Equity
- Hybrid

**SMEs**
- Characteristics
  - Debt in addition to equity
  - Has monitoring & evaluation
  - Enhance professionalism in the VC industry
  - Managers are from industry
Existing initiatives on innovation are not inter-linked

Initiatives to promote innovation:

- Currently many research institutes, incubators & testing facilities available
- Highly dependent on Government funding - MOSTI, MTDC, MOF, SME Corp.
- Matchmaking & soft support services provided by CRADLE

AIM to streamline innovation initiatives under the National Innovation Strategy including rationalisation of Funds

Existing Initiatives

Further Support

- Platform for seamless support for innovation
- Joint public-private effort
- Use existing facilities and resources

Various types of support offered separately
SULIT HIP 3: Technology Commercialisation Platform (TCP) to encourage Innovation

**Context**
- SMEs face issues in accessing the national innovation system
- Many initiatives exist but are fragmented & not interlinked
- Mainly dependent on public funds & not linked to commercial funding

**Technology Commercialisation Platform**

- Designed to remove market barriers to innovation
- Provides a range of services including financing, technical assistance, market information, policy advice & capacity building programmes
- Built on the existing landscape, public or private.

Platform to be managed by private entity
Good initiatives to create high-growth companies and should be further expanded

1. **High Performing Bumiputera SMEs (TeraS)**
   - Develop world-class Bumiputera entrepreneurs across all 12 NKEAs
   - Able to compete without Government assistance after 2020
   - Assistance through pro-growth initiatives & high-impact programmes to provide business opportunities, talent and funding

2. **Green Lane for Innovative SMEs**
   - For innovative SMEs verified by SME Corp., MDeC, BioTech Corp., MTDC
   - To accelerate growth of potential SMEs & enhance their contribution to economy
   - Incentives such as Govt. & MKD procurement, interest rebate of financing and tax deduction for 1-InnoCERT

**To complement**

- All sectors
- Greater contribution to economy
- Larger pool of SMEs
- All segments
- All activities
**HIP 4: Catalyst Programme to promote more homegrown champions**

- Top high growth companies **generate bulk of additional GDP & jobs**
- **Popular strategy worldwide** to develop a select group

**Context**

**Technology Commercialisation**

- Start up
- Incubation
- Idea

**Homegrown champions**

- Provide comprehensive support over a period of time
- Select potential high growth firms

**Targeted approach** with total support:
- Bank guarantee
- Interest rebate on financing
- Govt. procurement
- Talent from abroad
- Mentoring

**Transparency in**:
- Selection & exit criteria
Strengthen existing initiatives to promote exports

Many current programs

- **Market Development Scheme** – matching grant for participation in overseas fares and missions
- **Double deduction** for export promotion
- **Brand development programmes**

Yet, small number of SMEs exporting

<table>
<thead>
<tr>
<th>Contribution of SMEs to National exports</th>
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<tbody>
<tr>
<td>19%</td>
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</table>

Existing Initiatives

Further Support

- **End-to-end** export facilitation
- Help create NEW exporters
- Planning and technical **advisory**
HIP 5: Going Export (GoEx) Programme to expedite internationalisation of SMEs

**Context**

- Uncertainty on new market entry & high upfront cost for information access are biggest deterrents to expand overseas
- SMEs require assistance from market experts (*private service providers*)

**Programme Management Team** *(Pvt. Sector)*

**Preparation & execution of Export Sales Plan**

- Customised assistance on steps to export
- Link to expertise to implement
- Link to buyers

**Emerging SME Exporters**

**Required services**

- Part payment for required services

**Targets:**
- New Exporters
- Existing Exporters (*new product / market*)

**Matching grant**
- Cost of Export Sales Plan (ESP) if needed
- Other support in ESP after proof of export arrangement

**Market driven** after initial success
Some initial support has started on innovation at grassroots

Yayasan Inovasi Malaysia (YIM) promote and inculcate creativity and innovation at grassroots, school & community through:

- Awareness & Community Engagement
- Strategic Platform
- Fund Raising & Promotion
- Innovation bank with 210 ideas

Existing Initiatives

Further Support

- Encouragement & infrastructure support
- Financial support to further develop the idea
- Technical and management advisory
Inclusive Innovation Programme

- Promote **rural transformation**
- Improve **business environment** for SMEs especially in rural areas
- Increase the **innovation pool**

**Context**

- **Technical + Mgmt. Advisory**
- **Support Facilities**
- **Linkage - Financing**
- **Promotional Support**

**Innovation targeted at masses**
(e.g. M-payment)

**Innovation from grassroots**
(e.g. cycle powered machine, low cost tablet)

**Commercialised Products & Services to mass markets (incl. Govt. procurement)**
Pilot study indicates programmes had positive impact

Net Impacts of Programmes: Recipient versus non Recipient

- Pilot study on 16,000 recipients
  - Positive impact on investment, total output / value add and TFP
  - No significant impact on labour productivity & wages

1% increase in programme support results on average 1.1 – 5.0% gain in performance depending on indicator

Source: World Bank based on DOSM Census and surveys (2000-07) and data from the Ministries and agencies