

Entrepreneurship

PROMOTING INNOVATIVE ENTREPRENEURSHIP

- ▶ In Korea, entrepreneurial dynamics are largely driven by micro firms that do not scale-up and are mainly concentrated in low-productivity sectors.
- ▶ Youth and women are largely under-represented in entrepreneurial activity compared to other OECD countries, leaving an important potential of talent and skills under-utilised.
- ▶ Korea has undertaken reforms to stimulate entrepreneurship and improve SME efficiency, but further efforts are needed to foster a more entrepreneurial culture and develop market-based financing for innovative and growth-oriented start-ups and SMEs.

What's the issue?

In Korea, start-up rates ranged between 14% and 18% over 2006-13, well above the 11% OECD average, but declined steadily over this period. Moreover, entrepreneurial dynamics are largely driven by micro firms that do not scale-up or grow and are mainly concentrated in low-productivity sectors such as retail and food and beverage. This contributes to the large and growing productivity gap with respect to larger enterprises. Productivity in SMEs fell from 53.8% of that in large enterprises in 1988, to only 30.5% in 2014. In the wholesale and retail sectors, the gap in labour productivity was the highest in the OECD in 2012 (see Figure).

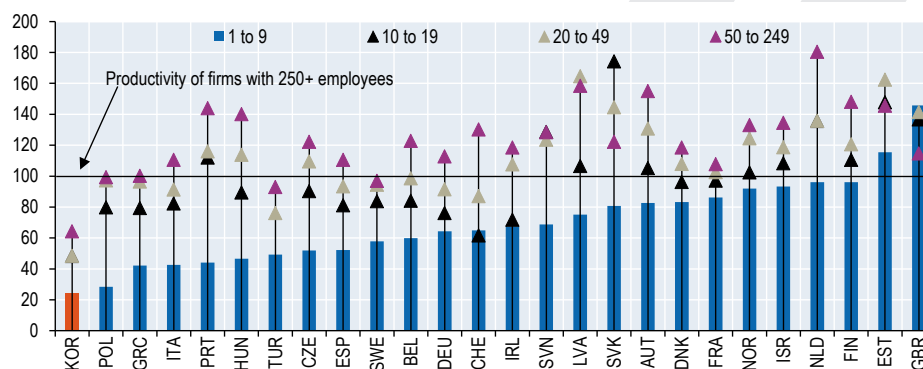
At 24.4% of all early-stage entrepreneurs, Korea had one of the highest rates of necessity-driven entrepreneurial activities (i.e. entrepreneurship because of no other option to work) among OECD countries

in 2015, although the rate of improvement-driven opportunity entrepreneurship (i.e. entrepreneurship to be independent or increase one's income) increased from 46% in 2012 to 62% in 2015. In addition, in 2013, in Korea's industry sector, high-growth enterprises accounted for 4% of firms with 10 or more employees, a lower rate than in most OECD countries, including the United Kingdom (13%), Germany (10%) and France (8%).

Regulatory and cultural barriers limit improvement-driven entrepreneurship. Product market regulation is among the most stringent in the OECD area. Perceived opportunities and capabilities to start a business are low compared to other OECD countries, while fear of failure is relatively high. Less than 40% of working age adults cite positive beliefs about entrepreneurship as a career, in contrast to other countries in the region, such as Indonesia

Service-sector SMEs in Korea are much less productive than larger firms

Value added per person employed in wholesale and retail trade, firms with 250+ employees in each country = 100, 2012 or latest available year



Note: Wholesale and retail trade includes repair of motor vehicles and motorcycles. For Korea, the size class "50-249" refers to "50-299" and the size class "250+" refers to "300+". Comparable data are available only for some services sub-sectors. This figure is thus intended as only illustrative of the wider service industry in Korea.

Source: OECD (2015), *Entrepreneurship at a Glance 2015*, OECD Publishing.

and the Philippines, where about three-fourths do. Youth and especially women in Korea are also less likely to become entrepreneurs than in most other OECD countries.

Access to finance also represents an important barrier to entrepreneurship and the expansion of SMEs. Government support for SME finance in recent decades has been substantial and has focused on traditional debt. However, bank lending is often ill-suited to newer, innovative and fast growing companies, which have a higher risk-return profile. While bank financing is crucial for many SMEs, a more diversified set of options is needed to boost SME long-term investment and ease the entry and growth of innovative enterprises.

As part of its 2013 Creative Economy Action Plan, the government has been prioritising regulatory reform and increased competition to stimulate entrepreneurship and improve efficiency. Several measures were taken to develop equity financing and the budget for subsidised loans and state investments in young innovative firms has also expanded significantly. But while equity investment is rising, its funding of start-ups is limited. In 2015, 68.9% of the total venture capital investment was in firms more than three years old, and 26.7% was in firms more than seven years old. Also, the large role of the government risks crowding out private investors. The government accounted for 30.3% of venture capital funds in 2015. The expansion of equity investment is also hampered by the underdevelopment of the market for mergers and acquisitions (M&A), though the government has started to address this constraint through tax incentives to encourage M&A among start-ups and the easing of regulations regarding M&A of new ventures by large companies.

To overcome negative cultural perceptions and improve entrepreneurial skills and opportunities, the government introduced the “Act on support of female-owned businesses” in 2009 and set up the “Young Entrepreneurs Start-up Academy” in 2011. In 2015, a plan was unveiled to establish a KRW 300 billion (0.02% of GDP) Youth Development Fund to support innovative youth activities. Furthermore, the government provides funds for investment and debt restructuring and has expanded the scope of protected assets during bankruptcy in order to facilitate a second chance for entrepreneurs. While these measures address important barriers to entrepreneurship, further efforts are needed to foster a more entrepreneurial culture in the population and tap into unexploited potential for innovation-driven entrepreneurship, particularly among youth and women.

Why is this important for Korea?

In 2013, SMEs represented 99.9% of enterprises and accounted for 86.8% of employment in Korea, but only 0.01% of small companies grew into medium-sized companies over 2011-14. The lack of growth dynamics in the SME sector largely reflects the low levels of innovativeness of entrepreneurial projects. Enhancing innovative entrepreneurship in Korea is crucial to increase productivity levels in the small business sector, exploit technological or commercial opportunities that are neglected by more established and larger companies,

What should policy makers do?

- ▶ Improve entrepreneurship and financial education as well as mentoring and coaching, especially among women and young people.
- ▶ Put in place bankruptcy and foreclosure procedures that facilitate a second chance for non-fraudulent entrepreneurs.
- ▶ Pursue policies to diversify financing instruments for start-ups and SMEs, in particular by promoting market based financing, leveraging private resources and developing appropriate risk-sharing mechanisms with the private sector.
- ▶ Focus venture capital on start-ups by facilitating early-stage IPOs in the KOSDAQ and KONEX markets.
- ▶ Take further steps to jumpstart the M&A market through regulatory reform.
- ▶ Ease entry regulation, in particular in services sectors.

challenge incumbents, stimulate competition, and generate high-wage employment. Innovation-driven entrepreneurial opportunities can also represent an important channel for economic and social participation and upgrading, and for tapping into skills and talent that may be currently unexploited.



Further reading

G20/OECD (2015), *High-Level Principles on SME Financing*. <https://www.oecd.org/finance/G20-OECD-High-Level-%20Principles-on-SME-Financing.pdf>

OECD (2016), *OECD Economic Surveys. Korea*, OECD Publishing. <http://www.oecd.org/eco/surveys/economic-survey-korea.htm>

OECD (2017), *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard*, OECD Publishing, forthcoming.