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Research Report

An Analysis of Corporation-SME Polarization

KDI Focus, No. 16

Provided in Cooperation with:

Korea Development Institute (KDI), Sejong

Suggested Citation: Kim, Joo-hoon (2012) : An Analysis of Corporation-SME Polarization, KDI Focus, No. 16, Korea Development Institute (KDI), Seoul, <https://doi.org/10.22740/kdi.focus.e.2012.16>

This Version is available at:

<https://hdl.handle.net/10419/200837>

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KDI FOCUS

August 22, 2012 (No. 16, eng.)

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An Analysis of Corporation-SME Polarization

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“The growing productivity gap between large corporations and SMEs stems from work force cuts, not increased levels of value added by larger companies. They are using their superior bargaining power to organize a division of labor between companies that allows for both high productivity and high wages.”

I. The Polarization Controversy

The term “shared growth” has recently come into common parlance in Korea. The fact that it has caught on so successfully is indicative of the widespread perception that SMEs are backwards and stunted in their growth. Large corporations, in contrast, are seen as having risen from their government-assisted beginnings to outpace SMEs by an ever-widening margin, gaining momentum in their growth from an increasingly entrenched market economy. They are also viewed as prone to taking advantage of their superior bargaining power to avoid guaranteeing SMEs a fair return for their efforts.

The recent measures adopted to alleviate polarization in Korea are understood to have their origins in a belief that non-market measures are absolutely essential, as this gap will continue to grow relentlessly if matters are left purely to the market economy.

But industry data from the past two decades raise fundamental questions as to whether these premises are even accurate. This paper examines the specific meaning of “polarization” in terms

<Table 1> Annual Rate of Increase in Shipments for Corporations and SMEs

	Manufacturing as a Whole	Corporations	SMEs
1990~2009	10.3%	10.0%	10.8%
1990~1997	13.3%	12.6%	14.3%
1999~2009	9.4%	9.3%	9.4%

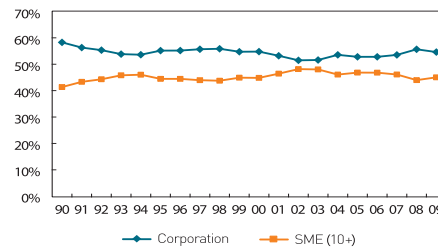
Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees. (As of 2007, Statistics Korea changed minimum workforce from five to ten.)
 Source: Statistics Korea, *Mining and Manufacturing Survey Report*.

<Table 2> Annual Rate of Increase in Value Added for Corporations and SMEs

	Manufacturing as a Whole	Corporations	SMEs
1990~2009	9.2%	8.7%	9.8%
1990~1997	13.9%	13.5%	14.3%
1999~2009	7.0%	6.7%	7.3%

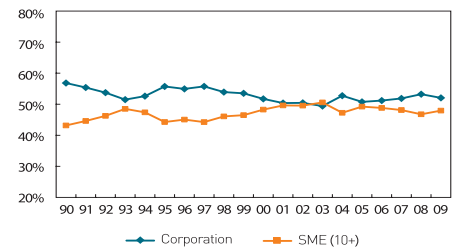
Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
 Source: Statistics Korea, *Mining and Manufacturing Survey Report*.

[Figure 1] Corporations and SMEs as Percentage of Manufacturing Shipments



Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
 Source: Statistics Korea, *Mining and Manufacturing Survey Report*.

[Figure 2] Corporations and SMEs as Percentage of Manufacturing Value Added



Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
 Source: Statistics Korea, *Mining and Manufacturing Survey Report*.

of the gap between corporations and SMEs—as among many forms of polarization that are part of the discourse in Korea—and suggests a direction for future policy measures based on its findings.

II. 'Polarization Happens When Only the Corporations Prosper'

It is difficult to concur that large corporations are enjoying higher growth rates than SMEs.

<Table 1> shows the rate of increase in shipments from the large corporation and SME sectors of the manufacturing industry over a recent 20-year period. For the sake of convenience, the period is divided into the years before and after the 1997 foreign exchange crisis, when the nature of the Korean economy underwent considerable changes. [Figure 1] graphs the respective weights of corporations and SMEs in manufacturing over the same 20-year period. In both cases, the numbers make it difficult to concur that large corporations enjoyed higher growth rates than SMEs over this time.

The corporation rate of increase also remained more or less the same in terms of value added, an indicator of profitability (see Table 2). By that standard, both types of business showed nearly identical trends over the 20-year-period (Figure 2), once again showing that the claims of large corporations outperforming SMEs are difficult to accept.

The above figures lead to a number of conclusions. First, both large corporations and SMEs have had relatively similar levels of performance over the past two decades. In other words, the widespread belief that corporations have been outperforming SMEs in recent years must be seen

as unsupported by the facts. In particular, the figures do not appear to support the contention that corporations have enjoyed stronger performance after acquiring greater freedom amid the greater climate of economic liberalization in the wake of the foreign exchange crisis.

Second, not only SMEs but large corporations as well saw significantly lower levels of performance following that crisis. If the government intervenes based on the mistaken perception that these corporations have become more profitable, this could have the effect of impairing the management conditions at those companies, thus risking a further deterioration of economic growth.

Third, the performance of SMEs was notably higher than expected. In this case, the numbers show the performance not of individual companies, but of SMEs as a group. The difference in image between the individual SMEs that people encounter personally and the ones represented in the statistics is attributable to a perceptual fallacy whereby we project our perceptions of individual businesses onto the whole SME group.

These strong levels of collective performance appear to be the result of a high rate of market entry. One noted hallmark of SMEs is their prolific rate of emergence and disappearance from the market. In an economy like South Korea's where the industry structure is becoming increasingly dynamic, structural changes associated with this characteristic are expected to become more and more severe. As the economic environment changes, many companies find themselves unable to adapt and exit the market, but many others find business opportunities in the new circumstances. It is through these entries and exits that the economy as a whole evolves to become better suited to the new environment.

The economy declines when there are more exits than entries, and grows when there are more entries than exits. If the SME sector is expanding due to a high rate of entry, then this means that the sector as a whole is growing, regardless of the situation for individual businesses. The previously observed fact that SMEs have enjoyed performance levels on par with larger corporations means, in turn, that a strong level of competitiveness is present within the overall sector. In terms of the national economy, these smaller businesses, with their increasing levels of production, value added, and hiring, are in need of reappraisal as growth engines.

III. Corporate Hiring Restrictions: The Epicenter of Polarization

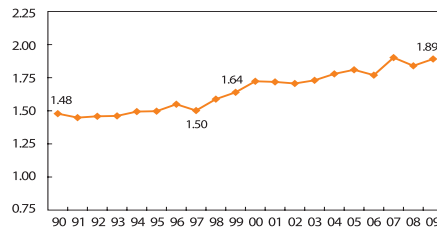
To what, then, can we attribute the widely perceived gap between large corporations and SMEs in Korea? <Table 3> shows the rates of increase in employee wages at the two types of business. From this, differences can be observed between the two in the years following the foreign exchange crisis.

To present this more clearly, [Figure 3] shows wages at corporations as a percentage of SME wages. As can be observed in the figure, the rate of increase in corporation wages grew between the pre-crisis and post-crisis period, pulling farther away from the average SME level in

The performance of SMEs as a group (as opposed to individual SMEs) was higher than expected.

The gap [between corporations and SMEs] has grown because the former have had higher rates of increase in their wage rates since the foreign exchange crisis.

[Figure 3] Changes in Per-Worker Wage Ratio of Corporations to SMEs (SME=1.00)



Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
 Source: Statistics Korea, *Mining and Manufacturing Survey Report*.

<Table 3> Annual Rate of Increase in Per-Worker Wages at Corporations and SMEs

	Manufacturing as a Whole	Corporations	SMEs
1990~2009	8.5%	9.7%	8.3%
1990~1997	13.5%	14.1%	13.8%
1999~2009	6.7%	7.8%	6.3%

Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
 Source: Statistics Korea, *Mining and Manufacturing Survey Report*.

the process.

If "polarization" is understood to mean a growing disparity in wage levels between large corporations and SMEs, then the facts would appear to support the contention that such polarization is currently an issue. The problem is that while wage rates have always tended to be higher for large businesses, the rate of increase has grown in the wake of the foreign exchange crisis, leading to an increasing disparity over time.

The first question that arises here is how such a difference could have emerged when the two types of business have been enjoying similar levels of growth in productivity and value added, which is the source of the ability to pay wages.

Amid increased campaigning by the labor community since the late 1980s, wage rates in Korea have risen rapidly, and frictions between labor and management have become a frequent occurrence. In response to this trend, labor-saving production methods such as automatization were increasingly adopted in order to reduce the dependence on workers. This meant an increase in the capital equipment ratio, or the rate of increase in per-worker tangible fixed assets. The change was especially marked at large corporations, which had the superior capital strength to effect it.

This increased use of capital-intensive production methods by large corporations led to a rapidly widening productivity gap with SMEs. In 1990, SME labor productivity—i.e., value added produced per worker—was at 51.5 percent that of large corporations. By 1997, it was all the way down to 41.4 percent (see Table 5 and Figure 4). This growing disparity stemmed not from a higher level of value added generated by large corporations, but from workforce cuts.

The equipment investments made to replace worker dependence had the effect of depressing the increase in wage levels. During the years from 1990 to 1997, wages increased at a lower rate than productivity (see Tables 3 and 5). At large corporations, where this increase was being checked by equipment investments, the rate was a mere 0.3 percentage point higher than at SMEs (Table 3). Accordingly, corporation wages as a percentage of SME wages increased only slightly between 1990 and 1997, from 148 percent to 150 percent (Figure 3).

The period after the foreign exchange crisis brought a different set of circumstances altogether. To begin with, equipment investments by large corporations—that is, increases in tangible fixed assets—fell by a striking degree, a fact attributable not only to the tailing off of the

In the pre-crisis period, wage rate increases at large corporations were kept in check by equipment investments to substitute for workers.

<Table 4> Rate of Increase in Tangible Fixed Assets at Corporations and SMEs

	1983~90			1990~97			1999~2006		
	All	Corporations	SMEs	All	Corporations	SMEs	All	Corporations	SMEs
Tangible fixed assets	19.5%	17.2%	23.9%	15.3%	15.0%	15.9%	4.3%	2.3%	7.0%
Employees	4.1%	1.7%	6.0%	-2.6%	-4.9%	-1.2%	0.9%	-0.4%	1.5%
Tangible fixed assets per worker	14.8%	15.2%	16.8%	17.6%	20.8%	17.3%	3.4%	2.7%	5.5%

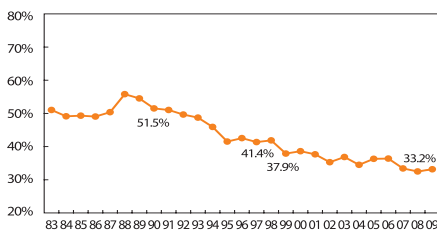
Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
Source: Statistics Korea, Mining and Manufacturing Survey Report.

<Table 5> Rate of Increase in Per-Worker Value Added at Corporations and SMEs

		1990~97			1999~2009		
		All	Corporations	SMEs	All	Corporations	SMEs
Annual Rate of Increase	Value Added	13.9%	13.5%	14.3%	7.0%	6.7%	7.3%
	Employees	-2.6%	-4.9%	-1.2%	0.9%	-0.4%	1.5%
	Per-Worker Value Added	16.9%	19.3%	15.7%	6.0%	7.2%	5.8%
Productivity Gap (Corporation = 100.0%)		(90) 51.5% → (97) 41.4%			(99) 37.9% → (09) 33.2%		

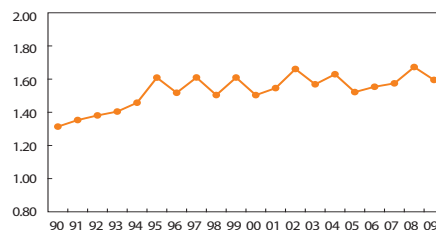
Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
Source: Statistics Korea, Mining and Manufacturing Survey Report.

[Figure 4] SME Productivity as Percentage of Corporation Productivity



Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
Source: Statistics Korea, Mining and Manufacturing Survey Report.

[Figure 5] Changes in Unit Labor Costs Ratio of SMEs to Corporations (Corporation=1.00)



Note: For statistical consistency, "SME" is defined as a business with 10 to 299 employees.
Source: Statistics Korea, Mining and Manufacturing Survey Report.

growth curve post-crisis but also to a renewed rise in hiring (or a reduction in hiring avoidance by corporations) amid an increasingly flexible labor market. In other words, businesses were no longer beefing up their equipment investments to replace workers as they had been doing before the crisis.

This could mean that the check on rising wages at corporations was taken away. In the post-crisis years, wages increased by 7.8 percent at large corporations, or 1.5 percentage points higher than the 6.3 percent rise at SMEs (Table 3). This contrasts sharply with the pre-crisis period, where, despite the wide productivity gap between the two kinds of businesses, the difference in the rate of wage increase was a mere 0.3 percentage point.

In summary, although large corporations saw a much higher rise in productivity than SMEs before the crisis, their wage rates did not increase accordingly. In terms of unit labor

costs(ULCs), which estimate wages outlays relative to labor productivity, large corporations had decreasing ULCs relative to SMEs (the upward trend in Figure 5).

In contrast, the post-crisis period saw an equilibrium reached in corporations and SME ULCs, indicating that workers at the former were neither being denied wages commensurate with their higher productivity nor being paid at higher levels relative to the productivity gap with SMEs. Indeed, the productivity growth gap between the two types of business was 1.4 percentage points after the crisis (Table 5), while the wage growth gap was 1.5 percentage points (Table 3), indicating a continued balance between the two.

Viewed purely in terms of economic logic, the growing post-crisis wage gap between corporations and SMEs was arguably a kind of normalization; rather, it was the failure of the wage gap to keep pace with the productivity gap in the pre-crisis years that was abnormal. To put it differently, corporations had high levels of productivity and wages after the crisis, while SMEs suffered low levels of both.

There is, however, one point that should not be overlooked here: the reason for the increase in corporation productivity. Since productivity is value added divided by number of employees, it increases both when value added increases and when the number of employees decreases. What enabled corporation productivity to increase relative to SME productivity in both the pre- and post-crisis years was the reduction in the number of their employees.

Why did staff cuts take place at large corporations?

Why did these corporation staff cuts happen? At first blush, one may conclude that the aim was to strengthen their capital-intensive production methods. But this is not adequate to explain the phenomenon, as SMEs saw a greater increase in their capital equipment ratio (tangible fixed assets per worker) than corporations in the post-crisis period (Table 4).

A more compelling explanation can be found by considering the fact that SMEs exposed to an intensely competitive environment would have expanded their hiring, even if this detracted from their productivity or wage rates. The hiring cuts at corporations, in contrast, may have been caused by a competition-restrictive structure.

The reason for corporations' superior bargaining power is their control of channels for communicating with the market.

The first conceivable explanation here is that corporations used their superior bargaining power to organize a division of labor where they could enjoy both high productivity and high wages. This strength is attributable less to their large production scale than to their control over channels to the market based on consumer trust.

A second possible factor is the incomplete push for labor market reforms at the time of the crisis. Irregular (temporary) and dispatch positions were introduced to promote flexibility, but implementation was not completed after an intense outcry from full-time corporation employees. This may have given rise to distortions in the corporate labor market, allowing larger businesses to maintain high levels of productivity and wages through limited hiring.

Thus, the way toward resolving the polarization issue must come, if not from politically motivated demands to promote equity, then through measures to address goods market distortions that arise from asymmetries of information (the failure of SME products to earn consumer trust, the SMEs' imperfect market analysis abilities) or labor market distortions

stemming from full-time corporate employees' defense of their vested interests.

IV. Policy Recommendations

If the issue of corporation-SME polarization that Korea confronts today is to be resolved, there first needs to be development of the channels linking SMEs to the market. The reason that these smaller companies end up saddled with the costs of the high wage rates at corporations has to do with the fact that those corporations control the channels of the goods market. This highlights the need for specialized business service training in areas such as marketing and market research, along with the development of ideas for lowering media advertising barriers. Trust in government's quality inspections should also be promoted to clear a path for SME brands to enter the market.

Second, steps should be taken to correct distortions in the corporation labor market. Ever since the foreign exchange crisis, a major theme of labor world policy has been the need to reduce overprotection of full-time workers and remedy underprotection of irregular workers and the self-employed. Polarization is unlikely to be resolved unless this comes to pass.

Third, a number of regulations that were introduced on the assumption that large corporations would have superior economic performance are in need of reexamination. (This applies only the findings of the manufacturing industry analysis.)

Finally, the focus of SME policy needs to be shifted from responding to the circumstances of individual SMEs to supplying club goods or public goods to SME groups. Evenly distributed support has the effect of offsetting competitiveness improvements at SMEs in relationships of competition and confounding their development of bargaining power vis-à-vis large corporations. Access needs to be made available to all, and businesses with outstanding entrepreneurial ability should be put to greater use in helping growth. One good example here may be the Quality of Working Life (QWL) programs recently instituted in complexes where large numbers of SMEs are based, in an effort to provide appropriate facilities to enhance their working environment.

Evenly distributed support has the effect of offsetting competitiveness improvements at SMEs and confounding their development of bargaining power vis-à-vis large corporations.