

Korean SMEs' Management Performance in Southeast Asia and Its Policy Implications

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As Golovko and Valentini (2011) pointed out, the level to which small and medium-sized enterprises (SMEs) enter overseas markets can serve as an important measurement of their business performance. While many Korean SMEs have entered the Southeast Asian market, there are still very few studies that have conducted fundamental research of their management. Instead, there have been abundant studies on how to enter the Southeast Asian market, listing the needs of Korean companies that wish to enter the region. When considering the recent status of Korean SMEs in Southeast Asia who are establishing a regional production network (RPN) with major Korean corporations, there is a need for current data on the management of Korean SMEs in Southeast Asia, upon which future directions can be based and government support policies prepared. This study aims to address this need.

I. Changes in External Environments in Southeast Asia

We first explore how the economy of Southeast Asia is affected by changes in external circumstances, such as the slowing of

China's economic growth, low price of raw materials, collapse of mega-FTAs, and the recent strengthening of protectionism. Fortunately Vietnam, which is the largest investment destination of Korea, still maintains a market-opening tendency even after a reshuffling within the Communist Party in 2016 which placed conservative figures in the top leadership positions. Despite the US' withdrawal from the Trans-Pacific Partnership (TPP), the Vietnamese economy has not been adversely affected because the opacity of the Vietnamese economy has been reduced during the process of its seeking membership in the TPP. Moreover, the nation has continued to maintain a trend of opening its economy, pushing for an FTA with the EU to cope with the US' withdrawal from the TPP. As Vietnam opens its market widely, however, Korean SMEs operating in the country may face various exposure risks resulting from a higher level of competition. Meanwhile, Indonesia is trying to foster its own industries through the utilization of trade policies. For example, a company that wishes to export raw ore must meet the Indonesian government's requirements, such as construction of a smelter fa-

cility and payment of export tax. In the case of LTE mobile phones, starting from January 2017 foreign products can be sold locally only if more than 30% of their parts are supplied from within Indonesia.

Changes in the international trade environment could affect trade policies, which might affect the performance of Korean SMEs in Southeast Asian countries. Our study, however, found that Korean SMEs in Southeast Asia were not directly affected by the policy changes in Vietnam, Myanmar, Indonesia and Cambodia. Instead, rising labor costs and tax collection have a larger impact than changes in the international trade environment. This is because most SMEs rely solely on orders from large companies. 58.2% of the head offices located in Korea predicted that these changes in the international trade environment will persist in the long term.

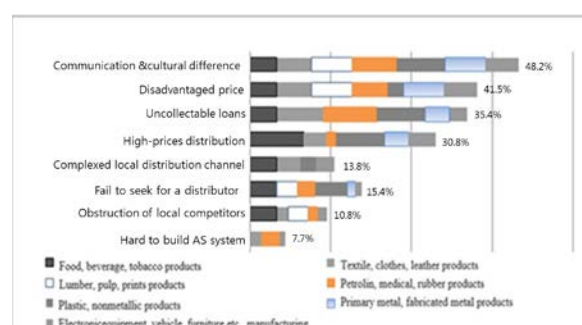
II. The Management and Business Performance of Korean SMEs Working in Southeast Asia

We analyzed the surveyed data on the management and business performance of Korean SMEs working in Southeast Asia. The results offered implications on how to prepare SME support measures and plan business restructuring. The Korean SMEs report that they are hindered by complicated administrative systems, cultural differences, and sudden changes of attitude on the part of licensing agencies and investment partners rather than the substandard infrastructure. SMEs with large amounts of sales were able to secure some degree of bargaining power with local and central governments and thus

experienced less difficulties from administrative procedures. Meanwhile, most Korean SMEs in Southeast Asia relied on their head offices for financing; only 25% of respondents answered that they use local financial institutions. In particular, the need to include support for these head offices was evident when considering that SMEs entering Southeast Asia require guarantees by their parent company if they are to access funding from local finance institutions.

The incumbent SMEs and those newly entering the market suffered from different reasons. Firms arriving at a later point reported that communication and cultural differences were the biggest obstacles (see Figure 1). Given that most incumbent SMEs in Southeast Asia report rapidly rising wage levels as the current biggest challenge, the characteristics of new-comers differ from those of incumbent firms.

Figure 1. Korean SMEs domestic sales difficulties by industry (%)



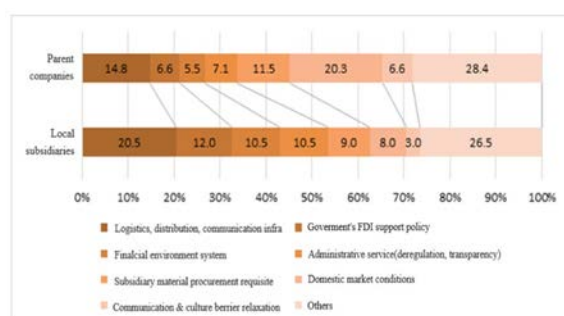
Note: Multiple responses allowed.

Source: Survey

In addition, it was obvious that local subsidiaries have more information about the region than their parent companies (see Figure 2). Korean firms seeking entry into the market, or companies that wish to start a business in Southeast Asia, can be linked with

the incumbent SMEs already working in the market, which would increase their likelihood of success. Since private companies are not apt to easily share their information with new-comers, it will be necessary to establish a support policy that enables SMEs to collaborate with each other.

Figure 2. Outlook of investment environment improvement from Korean SMEs and their parent companies over the next 3 years



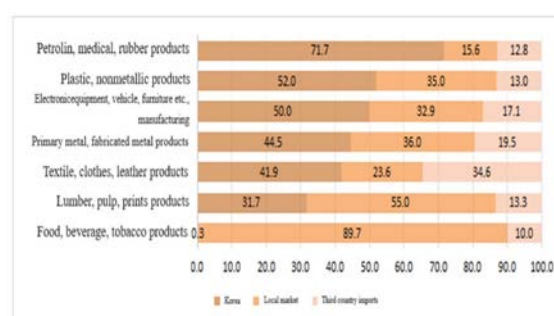
Note: Other items included foreign living conditions (education/medical/housing, etc.), labor management (wages, labor law, labor-management relations), investment location, development of related industries, tax environment and intellectual property rights. The expectations for improvement in the local subsidiaries and their parent companies were more or less similar.

Source: Surveys

Korean SMEs in Southeast Asia procure 31.8% of the raw materials they need from local sources, 46.3% from Korea, and 21.9% from third countries (see Figure 3). Also, Korean-made production facilities, including both used and new equipment, accounted for 54% of all facilities operated by Korean SMEs in Southeast Asia. In terms of total sales by region, the domestic sales of Korean SMEs account for 47.2%, exports to third countries account for 37.2%, and re-exports to Korea account for only 15.6%. From these results, it is safe to say that Korean SMEs in the region are making a great contribution to Korea's exports to Southeast Asia rather than lowering Korea's exports. On the other hand, we fail to find any empir-

ical evidence that investment decisions into Southeast Asia had a negative effect on the management indices, sales, production scale, number of employees, and R&D workforce of the parent company. Only in the case of plastic/non-metal companies did the sales, production volume, number of employees, and R&D workforce all decline following such an investment decision, but this is because they pulled out of Korea and moved to Southeast Asia due to environmental issues.

Figure 3 Comparison of the % of original material supplier in Korean SMEs by industry



Source: Surveys

Localization is being emphasized to improve the sustainability of SMEs located in Southeast Asia and the functions of local subsidiaries are gradually being strengthened. Most of the decisions directly related to production such as delivery, employment, and selling prices are made locally, but investment decisions are made by the Korean parent companies, including issues such as new market development, new product development, expansion of production facilities, and financing procurement. In terms of profitability, SMEs that perform various functions such as production, sales, and research and development are more profitable than SMEs that perform only production functions. Satisfaction levels with profitability are not likely to be as good as expected when firms use Southeast Asia simply as a

production base. Therefore, it is necessary to carry out activities across the value chain of production, R&D, and sales through localization, and consulting support is needed to decide on an appropriate range of decisions related to the value chain.

On the other hand, we fail to find evidence of any significant relationship between business function and growth of SMEs. This can be explained that Korean parent companies consider their local branch in Southeast Asia as a tool to generate short-term profit. Such a situation would lead to the parent company making decisions based on the needs of buyers or large corporations without any long-term development plan.

Meanwhile, SMEs are able to cope with changing situations in a flexible manner because their capital size is relatively smaller than large corporations. This could be another reason not to establish a long-term development plan. Considering the sustainability of the firms, however, it is necessary to establish a long-term growth plan. The long-term development plans of Korean SMEs should include plans to grow together with local SMEs, so Southeast Asian and Korean SMEs can grow together if they can establish deep roots in the field. Also, when considering the demographic structure of Korea, there is a limit to continuous export of commodities, meaning it is important to build a structure where the fruits of growth are shared through equity investment or M&As with local companies.

The SMEs did not feel that changes in the international trade environment affect their profitability and growth. Korean SMEs expected any changes in the international trade environment to have a long-term impact on profitability and growth and thus did not

recognize the need for immediate action. This is because most of these SMEs supply products to large multinational corporations rather than export directly. Finally, we analyzed the difference between the perception of management performance between Korean parent SMEs and their local subsidiaries to date. Empirical results showed that there was no difference in profitability between the parent SMEs and their local subsidiaries. However, the profitability and growth potential of local branch subsidiaries were assessed as higher than that of their Korean parent SMEs, despite recent changes in trade and investment policies. This means that the parent SMEs regarded the performance of local branch subsidiaries as better than theirs in the long term. This result confirms the motivation for Korean SMEs to transfer their production facilities to Southeast Asia, meaning it will also be necessary in the long run to differentiate the functions performed by Korean parent companies and their local subsidiaries along the value chain. Meanwhile, the fact that Korean parent companies tended to be more optimistic about the local situation, while lacking accurate information, could lead to certain risks in their management. This is particularly worrisome in that the Korean parent company is the party who decides to enter into the new market.

III. Directions and Implications for Korean SME Support Policy

Based on the results above, the following directions and implications can be gained when it comes to establishing SME support policies for Korean SMEs in Southeast Asia. As the global production network expanded, Southeast Asia became the outpost of Kore-

an production. In the survey, we find that a significant portion of raw materials and capital goods were procured from Korea. We also confirmed that 54% of capital goods were imported from Korea. Therefore, it is necessary to consider expanding support for SMEs entering Southeast Asia as an export expansion plan. As Japan recognized the importance of supporting their SMEs in Southeast Asia, various measures were implemented to support Japanese SMEs.

Meanwhile, while companies who have already established themselves in the region possess more information on local conditions, it is difficult to expect private companies to freely share their information with companies newly entering the market. Thus we suggest that the support policy for the SMEs entering into Southeast Asia should be built as a reciprocal ecosystem for collaboration between incumbent companies and new entrants. Construction of a research infrastructure may reduce the information gap between these firms and help them to grasp the business situation in Southeast Asia. Therefore we could consider building an incentive system for local SMEs to share information with new entrants into the market. Moreover, Korea has to work as a direction setter for the ASEAN regional production network by constructing a long-term roadmap.

Second, it is necessary to provide a tailored support plan based on the actual status of Korean SMEs already operating in the region. Since most of the support policies for these SMEs are concentrated at the pre-export promotion and overseas expansion stages, support for the SMEs that have already entered the foreign market is relatively poor. In particular, since Korean companies report their difficulties with labor and tax

issues, it is necessary to establish a specialized center in the relevant field and cultivate relevant experts locally. If there are no professional qualifications system available locally, it is necessary to support the formation of such a professional qualifications system through bilateral negotiations. Official development assistance (ODA) funds, corporate social responsibility (CSR) or creating shared value (CSV) funds can be utilized as a source of funds for this purpose.

Third, a plan must be prepared to support the restructuring of business in line with the reorganization of the regional production network in Southeast Asia. As the economic conditions of China and Thailand changed, the Japanese government encouraged its firms to adapt a “China plus One strategy” and “Thai plus one strategy.” With the launch of the AEC at the end of 2015, a single market and single production base has been established in the region. Along with these changes, measures to promote mega FTAs involving ASEAN, along with changes in industrial and trade policies in each country have had an impact on the overall economic structure of Southeast Asia. These policy changes and the changes of surrounding conditions in Southeast Asian countries are leading to a demand for reorganization of the regional production network in Southeast Asia. Therefore, it is necessary to establish a plan to support Korean SMEs that have entered the Southeast Asian market to freely restructure their businesses.

Finally, regional experts are indispensable when it comes to strengthening economic cooperation with Southeast Asia. It is absolutely necessary to train more regional experts. There is no way to lead a stable relationship between the two regions without being well-acquainted with the regional in-

formation. It is essential to expand mutual understanding first, based on which economic cooperation can be strengthened. **KIEP**