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## Tale of two Koreas

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**Abstract:** The economic performances of North and South Korea over the past decade have differed significantly. This is largely due to the government policies of the two countries, which affect business in conflicting ways. Despite the differences in economic growth, there are a number of similarities between North and South Korea, which are examined in this paper. More importantly, the resource endowments of North Korea, together with the human capital of South Korea, could combine successfully to foster entrepreneurship. This paper discusses the legal, cultural and business environment of North and South Korea and discusses the important possibilities for business development particularly in the small business sector between the two countries.

**Keywords:** Korea; entrepreneurship; small business; management.

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Vanessa Ratten's main research areas are alliances, international entrepreneurship and technology management. She is particularly interested in how entrepreneurship is fostered by culture and government policies around the world. In addition, having majored in Chinese linguistics at university and studied Bahasa Indonesian and Japanese at university, she is particularly interested in Asian languages and the role that they have in international business. She has published in numerous journals including the *International Journal of Entrepreneurship and Small Business*, *Journal of Enterprising Communities: People and Places in the Global Economy*, *Journal of Management and Organisation*, *European Journal of Innovation Management*, *International Journal of Educational Management* and the *Asia Pacific Journal of Marketing and Logistics*.

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## 1 Introduction

Much business press has focused on South Korea. As a democratic country located in Asia, South Korea has achieved a strong economic growth rate during the last decade (Bae and Rowley, 2004; Dana, 2007). In contrast, North Korea achieves more attention in the media as a result of its nuclear experiments. Hence, in the past 50 years, there has been an increased dichotomy between North and South Korea.

The history of Korea is important in helping to understand entrepreneurship in both North and South Korea. In 1940, Korea was an important trade partner of the Japanese Empire. North Korea had an abundance of natural resources including coal, iron ore and graphite. Rivers, like the Yalu, the Taedong and the Tumen provided transport for these natural resources. According to its factorial endowment, it was the most promising part of the country.

North and South Korea evolved from the same origins, yet due to diverging economic and social objectives their pattern of development now differs greatly (Yang, 2006). After 50 years of separation, North Korea is, according to socio-economic standards, one of the poorest countries on earth, the last Stalinist nation, and it is suffering from an ongoing flow of illegal emigration. South Korea, on the other hand, is now the USAs' seventh largest trading partner and has a strong reputation in the export of technology products and services. South Korea's industry now comprises 67% service industries. However, South Korea has experienced several difficulties (Bae and Rowley, 2004; Dana, 2007). Conflicting interests between citizens and organisations within South Korea are emerging due to the changing political-economic environment (Yang, 2006). Indeed, South Korea has experienced one of the largest rates of emigration with many of its citizens immigrating to countries including the USA, Canada and New Zealand. South Korea is one of the most ethnically homogenous countries in the world.

Despite fundamentally different economic perspectives, both countries are realising the value of developing small business. In South Korea, the government has called for innovation in order to allow the Schumpeterian entrepreneur to emerge, which will provide the country with an environment for entrepreneurship. North Korea is in desperate need of foreign currency to purchase basic necessities and small business will provide a means to sell goods on the international markets. North Korea's population is impoverished, with only a shift in the fundamental economic policies of the country providing a remedy of this critical situation and imminent collapse.

In 2006, more than half of South Korea's exports was generated by small business. In South Korea, the rate of employment in small businesses has been growing, as well as the part of production manufactured by this sector (Dana, 2007). In contrast, North Korea lacks food, machinery, and light industrial goods. Entrepreneurship in North Korea is scarce despite the natural endowments of the country.

## **2 Similar cultural legacy and dependency on small business**

The history and development of both North and South Korea is critical to understanding how entrepreneurship has developed in both regions. Since the Chosun dynasty ended, Korea has undergone significant change. During the 1940s and 1950s, Korea was under Japanese colonisation, which meant the economy exclusively developed in accordance with Japanese needs and policies. The Korean War led to the separation of the country along the 38th parallel in 1953, and since then, both countries took two fundamentally diverging ways of development. However, such a common past led to an array of similarities. This historical legacy still shapes both the North and South Korean economies and confirms the cultural influence on socio-economical assets. Both countries have populations, which are ethnically homogeneous and respect the same religious and social norms: the values of either Buddhism or Confucianism. Whereas North Korea benefits from natural resources such as coal, iron, magnetite, graphite,

copper, zinc, and lead, South Korea principally relies on mining and human capital (Bae and Rowley, 2004). Hence, both North and South Korea remain complementary: the resources from the North and the capabilities and skills from the South could be integrated due to the shared culture and values.

Despite these commonalties in demographics and cultural features, both the North and South Korean economies have an opposing perception of entrepreneurship. This is in contrast to the cultural and sociological similarities of the two countries leading one to assume the entrepreneurship spirit is basically the same. However, entrepreneurship in North and South Korea has diverged due to differing government policies that have shaped competitive environments and business developments (Dana, 2007).

As of 1948, President Kim Il-song, designated as such in 1972, implemented a Stalinist style dictatorship in North Korea. He encouraged heavy industry at the expense of light industrial goods and agriculture. Succeeded by Kim Chong-il, the centrally planned economic policy has been maintained. North Korea's economy is socialised at 90%: the land is collectivised, and 95% of the industries are state-owned. Although the official goal has always been self-sufficiency, North Korea relied on Soviet subsidies and exports until the Communist Empire collapsed and has more recently relied on China for aid.

In contrast to North Korea, South Korea heavily relies on foreign trade: its dependency on import and export markets is the outcome of a choice of development. The government in South Korea has successfully managed the shift from an agrarian economy to an export-oriented economy.

For decades, the power and pattern of growth in South Korea was concentrated in *chaebols*. South Korean business groups now rank amongst the world's biggest in terms of market capitalisation and growth (Lee et al., 2007). South Korean companies including Hyundai, Daewoo and Kia rank amongst the 5th largest exporters of cars. Telecommunications are also a major strength of the South Korean economy: contrasting with the non-existent North Korean network, South Korea is furnished with fibre optic and satellites. Moreover, thanks to strategically interventionism in favour of a high commitment into international markets, South Korea managed to educate its population and train the managerial workers, scale up and rationalise costs, exports and increase the value-added of its production (Lee et al., 2007). However, in South Korea, with the increase of unitarian labour costs and intensification of competition, giant business groups are relocating in cheaper world areas. Hence, the South Korean model is showing its limits with big automakers loosing market share and social claims are repetitively pushing people to strike (Bae and Rowley, 2004). Therefore, in South Korea as competitiveness decreases, entrepreneurship is becoming a critical asset, to implement innovation as well as to provide new employment opportunities (Dana, 1999, 2007).

The Soviet style system applied to North Korean culture inhibited business development, in contrast to the stimulating export-oriented market of South Korea. However, the necessity of developing a North Korean small business sector is also emerging from this pattern of economic organisation. With the collapse of the USSR, North Korea began experiencing food shortages. To feed its population, the country has been forced to import goods from foreign markets and is therefore required to earn foreign currency. Due to the inefficiencies of the state-owned industries, only individual businesses in North Korea can generate export operations. However, given the Korean cultural environment, in which incentives are provided by both North and South governments in order to promote the growth of the small business sector, is there any

opportunity for Korean people to share their assets in a mutually beneficial relationship? The next section will address this question by analysing the legal environment of both North and South Korea.

### 3 Contrasting legal frameworks

The economy built by South Korean leaders grew by 10.5% per year between 1982 and 1988 and created 2.8 millions jobs. The unemployment ratio sank to 2.5% during the same period. The giant business groups had the capital, critical mass and engineering to compete in petrochemicals, semiconductors, and cars. However, this pattern of growth lasted until the nature and structure of competition changed. The orientation of big groups on commodity products hinders competitiveness in fast changing markets like computers and software. Regionalisation and the implied protectionism toward non-regional partners emphasised the dependency of the South Korean economy. Finally, the level of industrialisation of South Korea called for a less controlled economic policy and a more limited moderated environmental approach. This combination of factors encouraged the South Korean government to rethink its model of growth by implementing change and promoting individual entrepreneurship. State-owned companies in the automobile and telecommunication industries have been privatised and open to foreign competition. The financial sector is also deregulated and many commercial banks now compete with one of the *chaebols*. In addition, the won which is South Korea's national currency is wholly convertible. Moreover, foreign investment is encouraged in South Korea with foreign companies being allowed to buy 25% of a company's equity. Thus, the South Korean government continues to encourage national champions but interferes less in the private sector.

Moving away from micromanagement, the South Korean government is allowing free enterprise to play its role. At the same time, it is recovering one of its social attributions by redistributing wealth to middle classes. During an interview in *Business Week* (July 31, 1995, pp.56–63), President Kim recalled his will to limit the growth of *chaebol* whose highly debt has been permitted by a subsidised interest rate system and loans guaranteed by the state.

In addition, in South Korea antitrust laws have been increased and the taxation system aims at facilitating the emergence of other competitors (Lee et al., 2007). Allowing Samsung to enter in the auto industry belongs to the new paradigm, in the sense that it consists in a diversification, not a consolidation of an oligopolist behaviour. By helping small businesses to set up in an innovating field, the South Korean government is acting in accordance with Korean ethnocentrist corporate culture (Nagano, 2006). Looking for improving their nation competitive level, South Korean is thus very sensitive to technology. If this emphasis on technology is associated with entrepreneurship with an appropriate legal system, then the South Korean government encourages the development of business and continuous innovation.

On the other side of the border, the objectives of the country are different. The final purpose is to earn foreign exchange. The North Korean government has not given up its belief in self-sufficiency, but accepts a small contribution from the outside world in activities such as farming and light industries. Thus, North Korea is willing to follow the same path China and Vietnam (Dana, 1994) took: to embrace market reforms in selected areas while maintaining a communist inspiration and state. Therefore, FDI has been

sanctioned since 1984 in the North Korean economy. However, Rajin-Sanbong became a free economic trade zone, whose aim was to drain regional capabilities, funds and purchasing power toward North Korea. One would assume the national purpose of earning foreign currency would mobilise any North Korean who is devoted to their country, with an idea to enter in business and to engage internationally. However, the missing facilities as well as the inappropriate legal environment led to a very different picture.

Indeed, as the initial dynamism during the 1960s had been hindered by a forced march to Stalinism, the possibility recently opened to the North Korean population is not sustained by a material reality. Hence, the existence of peasant markets is prevented by the planification and centralisation policies, as well as the availability of a cheap labour force. Instead of family farming, initiative is restricted to sub-work teams. They consist in 3 or 4 households with responsibility for a particular allocated section of cooperative land and the instruments to work it. To remedy food shortages, the North Korean government allows private farming by according each civilian 30 pyong of backyard cultivation, that is: 3.3 square metres, and remains small enough for a subsistence activity. The North Koreans are also deprived of the right to travel abroad. In addition, egalitarian and low nominal wages do not reflect the market forces, whose free movement has been inherited from the liberal ideals of Locke and Hobbes. Neither does the food rations and subsidised housing.

#### **4 Means of doing business**

Apart from the legal permissiveness, the second requirement to permit entrepreneurs to implement their ideas and, by this way, to achieve the government goal (earn foreign exchange) lies in the degree of adequacy of infrastructures. They provide the basic means of doing business for an individual entrepreneur who, by definition, cannot internalise such macro-variables (Dana, 1997). Since the 1960s, North Korea suffered from all the malfunctioning of a centrally planned economy. The extensive growth occurred at the price of overinvestment in heavy industry. Since then, investment has gone to coal, iron, steel, chemicals, metals, machine building, energy, rail transport, whereas agriculture, and light industry are lagging behind. A problem is that heavy industry is not workable by small business units, and, that no economic and technological reform has been introduced since the priorities designed by the first planification plans. Therefore, the heavy industries that North Korea is producing nowadays are old fashion and, in general, the technology is outdated.

Transport and communication are primitive by today's standards. The Japanese provided an extensive rail network for North Korea by which 70% of passenger traffic and 90% of freight is conveyed. However, parts of the country, mainly mountainous, remain isolated and links with border countries are scarce. However, thanks to the Rajin and Chonjin ports, transport of goods is possible to and from Russia and China, but the demilitarised zone between North and South Korea is still preventing direct contact. Roads in North Korea are unpaved and little improved since the Japanese period. Moreover, intercity busses do not exist. Individuals are not allowed to use cars in their private life and it is almost impossible for an independent entrepreneur to obtain facilities or storage for commercial purpose (Dana, 1997). In addition, large scale housing programs only provided a home to each family and the state of telecommunication dates

from the 1950s. In practice, there is no direct dialling; faxes and telex are few whilst radio and TV sets are fixed to receive only the stated channels. Electricity is also an important matter as despite North Korean endowment in brown coal and hydroelectric resources, the country still rests on foreign oil and suffers from chronic shortages.

Financial services are mostly provided by the state. Trade with outside belongs to the Foreign Trade Bank, which keeps a control on transactions. Insurance is also a state monopoly and even the retail sector is state controlled. Moreover, there is a short supply of consumer goods, whose quality is all the more very poor. Luxuries are a privilege of the elite, who consists of the communist nomenclature, whereas the egalitarian low wages are not encouraging consumption. However, like in South Korea, education is a success story in North Korea (Holstein and Nakarmi, 1995). Since 1972, school is mandatory until 16 and a system of kindergarten has meant that increasing number of women can work. However, disfunctioning consists of a narrow focus on pure and applied science at the expense of social science. Entrepreneurship has never been taught in North Korean universities, where there is no school comparable to South Korean business schools. Furthermore, this education system was essentially completed to facilitate ideological indoctrination, a skill, which still prevails in professional advancement.

South Korea enjoys a whole set of infrastructures ranging from transportation means, research centres devoted to commercial application, universities to telecommunication (Lee et al., 2007). In addition, despite its heaviness and its global inefficiency, the banking system is one of the densest of the world in South Korea. Finally, the strategic interventionism (Dana, 1993) of South Korea oriented the country toward international commitment, and, therefore, forced the companies to accept foreign rules, that is: market rules (Nagano, 2006). By contrast, the North Korean strategic interventionist policy, despite the same propensity of its population to set up business, aimed at fulfilling the regulations that were centred on freeing the country from external dependency.

## **5 The state of small business**

The goal of the North Korean government, hindered by an inappropriate legal and material environment, did not really lead to what industrialised nations mean by entrepreneurship. The cruel necessity to earn exchange is achieved through heroin traffic and criminality. Illegality is the only way to trade: it could consist either in cigarettes or alcohol smuggling with Scandinavia, or tourist complexes inside the country, all entrepreneurial initiatives are either constrained by law, or by 50 year old planification reflexes. As a result, much of the trade that exists within North Korea exists between China and the North Korean earning foreign exchange by work outside of the country.

In South Korea, the small business sector is continually growing even if the capital allocation system is slowly disappearing for a more entrepreneurial supportive loan system (Dana, 2007). Indeed, the bureaucratic banking system has no incentive to develop the credit risk analysis and rather invests in the stock market to bolster its performance. The system showed its limits in 1996, when share prices fell (Hoon, 1996). In spite of huge losses, there is an institutional resistance to reform the system. It would create a loss of power for officials and would imply job losses. The management system still suffers from the past errors. Furthermore, the various financial services are still partitioned, but the situation is changing. Deprived from resources, South Korea relies on its human resources and so does its economy. In addition, South Korean business

benefited from technology transfer with the West in energy, telecommunication and aerospace (Engardio, 1996). The South Korean adapted DRAM chips, display screens, production technology, but relied on Japanese capital equipment and components until the overvaluation of the yen changed the pattern of the exchange and many niches appeared to South Korean manufacturers. However, even if the banking system is now permitting small business to gather capital, there is still somewhat of a reluctance for innovation to emerge amongst entrepreneurs. The South Korean system can still learn from the Japanese and American R&D development process.

## 6 Conclusion

In South Korea, internal and external pressures have weakened the *chaebol* supremacy, whilst they create opportunities to small business development (Dana, 1999; Nagano, 2006). As shown by the strikes, which occurred during 1996 and at the beginning of 1997, workers asked for a share in the value-added gained from years of sacrifice. In 1997, the social movement pushed 360,000 textiles, chemicals, metals, mining, hospital, bank, and metro employees in the street, protesting against the law facilitating dismissal and increasing the length of working hours. Besides the social claims, which contribute to the rising costs, the won's appreciation led to a loss of comparative advantage (Hargreaves, 1993). Price competitiveness ceased to sustain Korean leadership, while global protectionism is affecting national growth, which has always rested on foreign market share. Increasingly, the position of manufacturers as Hyundai, Daewoo, and Kia is downgrading. The new type of competition South Korea will have to sustain is clearly based on diversity, quality, and technology, and will need workers who act innovatively. There is an obvious need to foster small businesses and the government seems ready to provide the appropriate environment. It already limits the participation of *chaebols* in business. The diffusion of wealth to middle classes is also encouraging entrepreneurial activity: people now buy houses, cars, appliances, and clothes. The internal consumption growth will provide the basis to consolidation of small businesses and give them the strengths to engage abroad.

As private conglomerates made small businesses starved for funds in South Korea, state-owned companies prevent capital markets to function and encourage anti-productive investment in North Korea. However, the adjustment period, demonstrates the potentiality of the inhabitants. North Korea is lacking of necessities such as rice, with which South Korea is furnished, and maize, which is not sufficient to feed the population. Mining minerals are also in insufficient quantity. Therefore, North Korea needs to produce light industrial goods to export and earn the currency, which will permit it to buy food, and also to increase the agricultural production. Fostering small business development is no longer a capitalist perverse attribute but a necessity, and North Korea has real potential. In addition, there are large quantities of gold and silver deposits in North Korea, which will further allow the development of the North Korean economy.

The landscape in North Korea is also very attractive. Japanese tourists, whose spending is usually substantial, are just an hour away. South Koreans could also be attracted by the mounts Paekdu and Kumgong. However, hotels and holiday resorts are still lacking in these areas. Moreover, North Korea shows a real capacity to trade. At the Chinese border, North Korean smugglers bargain wheat flour and corn, or even

cars and luxury goods in exchange of US dollars. The smuggling is very organised and specialised. National art is sometimes traded, as well as medicine. The North Korean army is also a major actor of the parallel economy (Hargreaves, 1993). All accomplish a vital function for North Korea, which needs to boost trade so as to survive. In Yanji as well, ethnic Korean constitute a sizable consumer base. Part of the waitresses' mission consists of earning foreign exchange and gathering intelligence from South Korean visitors. North Korean officials operate in trading-companies in China, where South Korean businessmen are also located. Besides this corporate culture, the 20–29 age group is growing, creating a pool of young and dynamic potential entrepreneurs. Thanks to the North Korean education system, technical proficiency is also very high even if commercial application are sometimes missing.

The combination of these factors lead to points of similarities between North and South Korea. Both countries have educated work forces, North Korean resources and South Korean market skills have potentialities for economical cooperation. In 1988, no trade occurred between the two Koreas. However, now South Korea is one of the largest partners of North Korea. The latter could benefit of an improvement of the relationships: starting by export-led growth, then moving up into higher value-added fields, a pattern that could not be achieved without external contribution. Moreover, South Korea seems to be the closest to North Korean spirit, cultures and practices.

The case of Korea offers an explicit demonstration of the impact of political systems on small business environment (Engardio, 1996). It shapes the regulation and the economic system of a society is also a function of the environment. Despite 50 years of diverging policies, a similar cultural background can be perceived in the Koreas' development modes. Nowadays, the awareness of leaders that a shift is needed, characterises both political and economic orientations. For South Korea, it implies an adjustment period, which will stress efficacy rather than market share, whereas North Korea will have to promote a competitive environment and separate political from economical preoccupation. Increasing entrepreneurship requires the change of capital allocation system of subsidised interest rates in South Korea, whereas North Korea has to move away from the centrally planned making decision process. Another focus will be to teach workers to act innovatively. The education system could help to achieve a Schumpeterian benefit rather than a disorganised small business development in South Korea. In North Korea, the reform will aim at providing a sustainable infrastructural and legal environment so as to permit desires to turn into concrete initiatives.

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