

KOREA

Key facts on SME financing

SMEs constituted 99.9% of Korean enterprises in 2013, with the vast majority being micro enterprises employing up to 9 employees (93.2% of employer enterprises). In 2011, SMEs employed for the first time more than 50% of the country's economically active population, with the number of SME employees standing at 1.3 million, according to Statistics Korea.

SME and total business loans increased over the period 2007-15 period by 51.7% and 78%, respectively. As loan growth for all business loans outpaced SME loan growth, the SME share of business loans declined from 86.8% in 2007 to 74.2% in 2015, which is still a high percentage by international standards, though.

The average interest rate charged on outstanding SME loans peaked in 2008 at 7.5%, then declined steadily to 4.7% in 2014, and decreased once more significantly to 3.9% in 2015 by 74bp, but still a relatively high interest rate compared with Western economies, which had taken loose monetary stances, in contrast to Korea.

Venture and growth capital investments declined between 2007 and 2008, as in other countries, but rebounded over 2009-11, exceeding their 2007 level. In 2015, venture capital investments grew strongly by 27.2% year-on-year, compared to 18.4% in 2014.

In 2015, payment delays again rose again somewhat to 9.2 days, but still well below the 12.1 days-level observed in 2008 and 2010. Bankruptcies decreased to 720 from 841 in 2014, by 14.3% year-on-year. It should be noted that while SMEs avoided bankruptcy because of the policies of the central and regional governments, they were still financially stressed due to low economic growth. The proportion of NPLs decreased sharply in 2011, decreased modestly over 2012-14, and decreased to 1.2% in 2015.

In 2015, the outstanding government guaranteed loans were at KRW 60.9 trillion which included loans that were backed by two nationwide funds. Direct loans provided by the SBC totalled KRW 3.9 trillion in 2015. These loans try to remedy market failures and enhance the competitiveness of SMEs. The Korean Government is now actively looking for other cost effective ways to support SME lending. In addition, it is planning on improving the policy-based financial system, in order to intensively support innovative small and medium enterprises via high-quality policy, rather than through quantitative expansion. For example, the new fund of funds for the Creative Economy (which is the current administration's main focus), that started to invest in innovative SMEs in 2014, raised additional funds worth of KRW 1.6 trillion in 2015.

The Bank of Korea raised the ceiling on its key loan facility for small and medium-sized enterprises by KRW 5 trillion in 2015. Additionally, as Korea's National Assembly has passed the legislation to legalise crowdfunding, SMEs can easily access equity financing through crowdfunding. Moreover, individual investors can diversify the investment on several SMEs without any additional operational cost.

Table 3.21. Scoreboard for Korea, 2007-15

Indicators	Units	2007	2008	2009	2010	2011	2012	2013	2014	2015
Debt										
Outstanding business loans, SMEs	KRW billion	368 866	422 439	443 474	441 024	454 899	461 556	488 980	522 426	560 703
Outstanding business loans, total	KRW billion	424 796	511 201	531 072	541 070	585 697	618 117	654 366	705 956	755 958
Share of SME outstanding loans	% of total business loans	86.8	82.6	83.5	81.5	77.7	74.7	74.7	74	74.2
Outstanding short-term loans, total; loans for operation	KRW trillion	319	375	373	372	388	395	405	419	426
Outstanding long-term loans, total; loans for equipment	KRW trillion	106	136	158	169	197	223	249	287	330
Total short and long-term loans, total	KRW trillion	425	511	531	541	586	618	654	706	756
Short-term loans ; loans for operation	% of total business loans	75	73.4	70.3	68.7	66.3	63.9	61.9	59.4	56.4
Government loan guarantees, SMEs	KRW billion	39 730	42 961	56 381	56 195	55 457	56 940	59 517	60 336	60 947
Government guaranteed loans, SMEs	% of SME business loans	10.8	10.2	12.7	12.7	12.2	12.3	12.2	11.5	10.9
Direct government loans, SMEs	KRW billion	2 480	2 635	4 812	3 098	2 957	3 149	3 715	3 269 951	3 901 944
Loans authorised, SMEs	KRW billion	2 721	3 201	5 821	3 416	3 353	3 345	4 178	3 579	4 190
Loans requested, SMEs	KRW billion	4 653 212	6 057 369	9 819 052	6 657 082	5 927 739	5 737 913	6 937	6 717	7 091
Ratio of loans authorised to requested, SMEs	%	0.1	0.1	0.1	0.1	0.1	0.1	60.2	53.3	59.1
Non-performing loans, SMEs	KRW billion	3 446	7 711	6 851	9 997	7 903	7 511	7 995	7 778	6 833
Non-performing loans, SMEs	% of SME business loans	0.93	1.83	1.54	2.27	1.74	1.64	1.64	1.49	1.22
Average interest rate	%	6.95	7.49	6.09	6.33	6.25	5.83	5.06	4.65	3.91
Interest rate spread (between average rate for SMEs and large firms)	%	0.76	0.79	0.56	0.54	0.55	0.43	0.24	0.18	0.16
Equity										
Venture capital, total amount invested	KRW million	991 692	724 690	867 096	1 090 987	1 260 836	1 233 300	1 384 500	1 639 300	2 085 800
Venture capital	Year-on-year growth rate, %	..	-26.9	19.7	25.8	15.6	-2.2	12.3	18.4	27.2
Other										
Payment delays, SMEs	Number of days past due date	11	12.1	9.9	12.1	11.7	9.1	9.7	10	9.2
Bankruptcies, total	Number	2 294	2 735	1 998	1 570	1 359	1 228	1 001	841	720
Bankruptcies	Year-on-year growth rate, %	..	19.2	-26.9	-21.4	-13.4	-9.6	-18.5	-16	-14.4

Source: See Table 3.21.4.

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SMEs in the national economy

SMEs constituted 99.9% of Korean enterprises in 2013, with the vast majority being micro enterprises employing up to 9 employees (93.2% of employer enterprises). Small and medium enterprises accounted for another 6.7% of all employer enterprises. Large enterprises with more than 250 employees constitute only 0.1% of all employer enterprises.

Table 3.21.1. Distribution of firms in Korea, 2013

By firm size

Firm size (employees)	Number of persons employed	%
All firms	2 798 139	100
SMEs (1-249)	2 795 865	99.9
Micro (1-9)	2 608 672	93.2
Small (10-49)	162 170	5.8
Medium (50-249)	25 023	0.9
Large (250+)	2 274	0.1

Note: Data includes financial enterprises with the exception of holding companies (ISIC Rev.4 sector 642).

Source: OECD, Entrepreneurship at a Glance, 2015.

StatLink  <http://dx.doi.org/10.1787/888933468056>

With the services industry in Korea growing at a high pace, and with the government focusing its efforts on nurturing and supporting small businesses, the status of SMEs is becoming increasingly more important for the national economy. In 2011, SMEs employed for the first time more than 50% of the country's economically active population, with the number of SME employees standing at 1.3 million, according to Statistics Korea. SME employees represented at 39.2% of the total workforce in 2000, and grew to 50.3% in 2011, following a consistent pattern of growth throughout this period.

SME lending

Korea's definition of an SME varies by sector (see Box 22.1). SME and total business loans increased over the 2007-15 period by 51.7% and 78%, respectively. SME loan shares were calculated on the basis of total outstanding business loans (i.e. stocks). As loan growth for all business loans outpaced SME loan growth, the SME share of business loans declined from 86.8% in 2007 to 74.2% in 2015, which is still a high percentage by international standards, though. The proportion of short term lending to total business lending continuously declined from 2007 (75%) to 59.4% in 2014, and further to 56.4% in 2015.

After the Korean currency crisis in 1997, large corporations (conglomerates) accessed financing through direct financing rather than bank loans. Meanwhile, the banking sector focused on household loans as well as on SME loans covered by government guarantees. Thus, SME loans increased dramatically over the following 15 years. However, lending to large enterprises has recently increased due to the increasing concerns about SMEs' credit risk and household debt problems.

Credit conditions

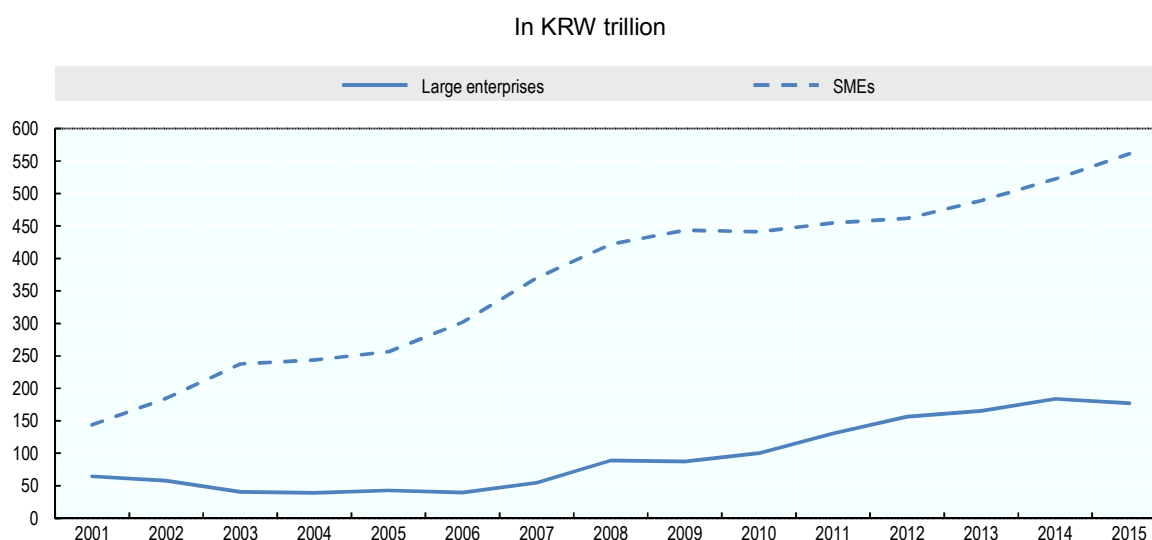
The average interest rate charged on outstanding SME loans peaked in 2008 at 7.5%, then declined steadily to 4.7% in 2014, and decreased once more significantly to 3.9% in 2015 by 74bp, but still a relatively high interest rate compared with Western economies, which had taken loose monetary stances, in contrast to Korea. The higher rates probably reflect the greater risks faced by Korean banks and inflation trends. The interest rate spread between SMEs and large firms also reached its peak in 2008 at 79 basis

points, and then dropped substantially in the following years to a low of 16 basis points in 2015 (compared to 18 basis points in 2014), which is low by international comparison.

Banks eased lending conditions for SMEs not because of their willingness to absorb SMEs' credit risks, which were high, but because of the government's advice to banks to automatically roll over loans to SMEs. Roll-over rates consequently reached 90%. The government justified this approach on the grounds that banks were not capable of making an accurate assessment of the viability of borrowers during the crisis. Additionally, government guarantee programmes, further discussed below, contributed to the banks' change in lending behaviour to SMEs, despite their own liquidity shortages and difficulty in meeting regulatory standards.

The ratio between loans requested and loans authorised declined sharply between 2007 and 2008, when almost half of all loan applications (47.2%) were rejected. The relative number of rejections improved in 2009, before reaching a low of 48.7% in 2010. Rejection rates decreased to 40.9% in 2015, from 46.7% in 2014.

Figure 3.21.1. Large enterprise and SME loans in Korea, 2001-15



Source: Financial Supervisory Service (FSS), Small and Medium Business Administration (SMBA).

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Alternative sources of SME financing

Venture and growth capital investments declined between 2007 and 2008, as in other countries, but rebounded over 2009-11, exceeding their 2007 level. In 2015, venture capital investments grew strongly by 27.2% year-on-year compared to 18.4% in 2014.

Table 3.21.2. Venture and growth capital in Korea, 2007-15

In KRW billion

Stage	2007	2008	2009	2010	2011	2012	2013	2014	2015
Early	365.0	290.8	247.6	319.2	372.2	369.6	369.9	504.5	647.2
Expansion	377.4	255.3	260.1	290.4	329.6	313.7	325.9	406.9	582.8
Later	249.3	178.6	359.4	481.4	559.0	550.0	688.7	727.9	855.8
Total	991.7	724.7	867.1	1 091.0	1 260.8	1 233.3	1 384.5	1 639.3	2 085.8

Source: Small and Medium Business Administration (SMBA).

StatLink  <http://dx.doi.org/10.1787/888933468062>

Venture capital investments were concentrated in the early and expansion stages in 2007. By 2015, venture capital investments were concentrated in later-stage firms (41%), whereas the early and expansion stages were 31% and 27.9%, respectively.

Other indicators

Data on payment delays were for loans overdue rather than for the average payment delays of customers, suppliers or government. Overdue loans declined in 2009, but rose again in 2011, only to drop to a low in 2012 (22.2% decrease compared to 2011). In 2015, payment delays rose again somewhat to 9.2 days, still well below the 12.1 days-level observed in 2008 and 2010.

Although many SMEs in Korea were financially pinched after the outbreak of the global financial crisis, they avoided bankruptcy, thanks to financial support from the government. In 2015, bankruptcies decreased to 720 from 841 in 2014, by 14.3% year-on-year. It should be noted that while SMEs avoided bankruptcy because of the policies of the central and regional governments, they were still financially stressed due to low economic growth.

Continuously higher growth rates in lending to large businesses compared to SMEs probably reflect a more conservative attitude on the side of banks at the end of the review period. At the beginning of the crisis, SMEs had access to credit despite the rather alarming rates of increase in non-performing loans (NPLs), which roughly doubled from 0.9% of all SME loans to 1.8% in 2008, and increased even further to 2.3% in 2010 (but remained still well below the levels observed in many other OECD countries). The proportion of NPLs decreased sharply in 2011, decreased modestly over 2012-14, and decreased to 1.2% in 2015. Data for non-performing loans include domestic and foreign currency loans.

Government policy response

There was a 42% increase in the amount of government guaranteed loans during the crisis (2007-09). Moreover, the guarantee coverage ratio was raised temporarily from 85% to 95%, and even to 100% in the case of export credit guarantees. While the Small Business Corporation (SBC) increased its direct lending by only 6.2% between 2007 and 2008, there was a significant jump in 2009 (83%). During the recovery, direct loans declined, indicating this type of government assistance was easing off. But at the same time, the SBC loan authorisation rate remained well above 50%. At the same time, the SBC increased direct lending in 2015 by 19.3% year-on-year.

In 2015, the outstanding government guaranteed loans were at KRW 60.9 trillion which included loans that were backed by two nationwide funds. Direct loans provided by the SBC totalled KRW 3.9 trillion in 2015. These loans try to remedy market failures and enhance the competitiveness of SMEs. The Korean Government is now actively looking for other cost effective ways to support SME lending. In addition, it is planning on improving the policy-based financial system, in order to intensively support

innovative small and medium enterprises via high-quality policy rather than through quantitative expansion. For example, the new fund of funds for the *Creative Economy* (which is the current administration's main focus), that started to invest in innovative SMEs in 2014, raised additional funds worth 1.6 trillion KRW in 2015. The Bank of Korea has raised the ceiling on its key loan facility for small and medium-sized enterprises by KRW 5 trillion in 2015. Additionally, as Korea's National Assembly has passed the legislation to legalise crowdfunding, SMEs can easily access equity financing through crowdfunding. Moreover, individual investors can diversify the investment on several SMEs without any additional operational cost.

Box 3.21.1. Definition of SMEs used in Korea's SME and entrepreneurship finance scoreboard

The BOK (Bank of Korea) and the FSS (Financial Supervisory Service) have the same definition of small and medium-sized enterprises (SMEs).

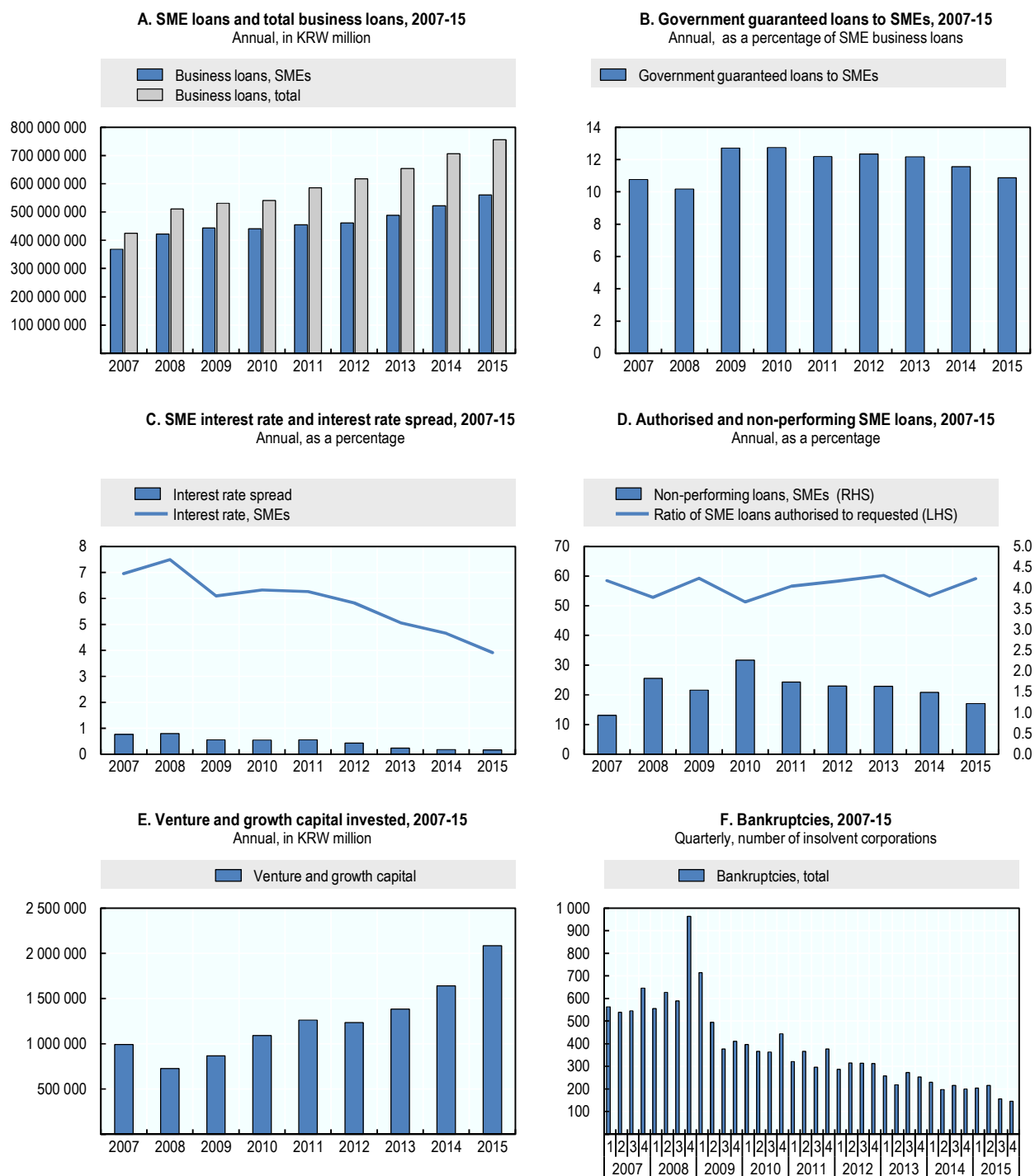
An SME denotes an establishment that has less than 300 regular employees or paid-in-capital less than or equal to KRW 8 billion (about USD 8 million). This definition of SMEs is based on the Article 2 of the Framework Act on Small and Medium Enterprises and Article 3 of its enforcement decree. SMEs can also be defined as follows:

Table 3.21.3. Definition of SMEs used by BOK and FSS in Korea

Sector ¹	SMEs		Small Business	Micro-enterprises
	No of workers	Capital & sales	No. of workers	
Manufacturing	Less than 300	Capital worth USD 8m or less	Less than 50	Less than 10
Mining, construction and transportation	Less than 300	Capital worth USD 3m or less	Less than 50	Less than 10
Large general retail stores, hotel, recreational condominium operation, communications, information processing and other computer-related industries, engineering service, hospital and broadcasting	Less than 300	Sales worth USD 30m or less	Less than 10	Less than 5
Seed and seedling production, fishing, electrical, gas and waterworks, medical and orthopaedic products, wholesales, fuel and related products wholesales, mail order sale, door-to-door sale, tour agency, warehouses and transportation-related service, professional, science and technology service, business support service, movie, amusement and theme park operation	Less than 200	Sales worth USD 20m or less	Less than 10	Less than 5
Wholesale and product intermediation, machinery equipment rent for industrial use, R&D for natural science, public performance, news provision, botanical garden, zoo and natural parks, waste water treatment, waste disposal and cleaning related service	Less than 100	Sales worth USD 10m or less	Less than 10	Less than 5
Other sectors	Less than 50	Sales worth USD 5m or less	Less than 10	Less than 5

1. General Criteria (Article 2 of Framework Act on SMEs and Article 3 of Enforcement Decree of the Act). For micro-enterprises, Article 2 of the Act of Special Measures on Assisting Small Business and Micro-enterprises shall apply.

Figure 3.21.2. Trends in SME and entrepreneurship finance in Korea



Source: Chart A: Financial Supervisory Service (FSS). Chart B: Financial Supervisory Service (FSS) & Small and Medium Business Administration (SMBA). Chart C: Bank of Korea (BOK). Chart D: Small and Medium Business Administration (SMBA). Chart E: Small Business Corporation (SBC). Chart F: Small Business Corporation (SBC).

StatLink  <http://dx.doi.org/10.1787/888933466603>

Table 3.21.4. Definitions and sources of indicators for Korea's scoreboard

Indicators	Definition	Source
Debt		
Business loans, SMEs	Bank (Commercial Bank + Specialised bank) loans to non-financial SMEs, amount outstanding, stocks.	Financial Supervisory Service (FSS)
Business loans, total	Business bank (Commercial Bank + Specialised bank) loans to all non-financial enterprises, amount outstanding, stocks.	Financial Supervisory Service (FSS)
Short-term business loans, total	Outstanding amounts, total business loans of less than one year.	Financial Supervisory Service (FSS)
Long-term business loans, total	Outstanding amounts, total business loans of greater than one year.	Financial Supervisory Service (FSS)
Government guaranteed loans, SMEs	Value of loans guaranteed by KODIT, KIBO; stocks.	Financial Supervisory Service (FSS) and Small and Medium Business Administration (SMBA)
Direct government loans, SMEs	Direct government loans supplied and executed by the SBC only	Small Business Corporation (SBC)
Loans authorised, SMEs	Direct government loans from the SBC data base (not from commercial banks). Includes executed and non-executed loans which have been authorised	Small Business Corporation (SBC)
Loans requested, SMEs	Direct government loans from the SBC database (not from commercial banks).	Small Business Corporation (SBC)
Non-performing loans, SMEs	Domestic Banks' SME non-performing loans out of total credit including Won-denominated loans, foreign currency-denominated loans, credit card receivables and others (outstanding amount).	Financial Supervisory Service (FSS)
Average interest rate, all loans	Average interest rates charged on new loans during the period, all loans.	Bank of Korea (BOK)
Average interest rate, SMEs	Average interest rates charged on new SME loans during the period.	
Interest rate spread (between average rate for SMEs and large firms)	SME loan rate - Large corporation loan rate.	Bank of Korea (BOK)
Equity		
Venture and growth capital	Annual amounts invested including early, expansion and later stages.	Small and Medium Business Administration (SMBA)
Other		
Payment delays, SMEs	Average days of delay past loan contract date.	Small and Medium Business Administration (SMBA)
Bankruptcies, total	Bankrupt firms in Small Business Corporation's portfolio.	Small Business Corporation (SBC)

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From:
Financing SMEs and Entrepreneurs 2017
An OECD Scoreboard

Access the complete publication at:
https://doi.org/10.1787/fin_sme_ent-2017-en

Please cite this chapter as:

OECD (2017), "Korea", in *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/fin_sme_ent-2017-31-en

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