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Environment of Doing Business in East Asia : South Korean Experience

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Abstract

Purpose – The purpose of this paper is to aim to stress the importance of doing business environment in South Korean economy. The theoretical justification is based on neo-institutional theories and new business management including Porter's Model as main justifications of state intervention due to the market failures to promote a competitive environment of doing business.

Research design, data and methodology – The methods to be taken is to provide a comparative performance analysis, and offer in terms of doing business and economic freedom sub-index complemented by Korean reforms diagnostics.

Results – The main results underlined the key factors explain the success of business environment in South Korea such as: a simplified registration procedures, a target tax incentives, the removal of business barriers, the improvement of legislative and regulatory framework, target reforms, property right and technical norms, good governance and the quality of institution, a role of a well-functioning legal framework, a strong competition framework, and the transparency of regulation, etc.

Conclusion – A competitive environment of doing business is based on the target national strategies, appropriate reforms responding to national needs and good governance system.

Keywords: Environment of Doing Business, Institutional Framework, Competitiveness, Competition Framework.

JEL Classifications: M10, M21, M31, N90.

1. Introduction

To Promote an environment of doing business become a priority for many developing and emerging economies, the experience of South Korea is analysed in this paper. Facilitating administrative procedures and authorization for the promotion of entrepreneurship, reducing the fragmentation of the regulatory framework, strengthening the competition framework, implementing a well-functioning legal framework ensuring intellectual property right, implementing effective rule of law and establishing an independent judicial system, developing a sophisticated financial system; all are included on the sets of incentives, rules and reforms, actions and programs needed to be implemented to promote business environment competitiveness in many developing and emerging economies. In fact, during the globalization process characterized by: the growing geographical fragmentation of production processes, the increasing of financial flows resulting from a combination of technological innovations as well as the emergence of a multilateral trade system to create a favorable international environment for trade. In this context, promoting and offering an appropriate environment of doing business is important for East Asian economies. My paper will be focused on South Korea experience. A brief conceptual test is offered concerning the environment policy. Then a theoretical foundation is offered based on endogenous growth theories, neo-institutional theories and strategic management theories with Porter Model. Then, a comparative performance analysis is offered concerning South Korea and an empirical test based on cross-section analysis based on environment of doing business in developing and emerging economies including South Korea economy.

To underline the importance of environment of doing business, it is important to answer to this question: do institutional framework is the main key for a competitive environment of doing business? Or just facilitating administrative procedures can resolve entrepreneurship barriers? Are some economies able to reduce the fragmentation of regulatory framework and in which way? Is asymmetry of information the main reason to strengthen the competition framework? And what about the effective rule of law, the independence of judicial system and appropriate financial system to build a competitive environment of doing business?

2. Brief outlook: Conceptual test

2.1. What is an environment of doing business?

The business environment is defined as a package of policy, legal, institutional, and regulatory conditions that govern business activities. It is included the investment climate as the administration and enforcement mechanisms established, the institutional arrangements, etc. Indeed, the World Bank (2005) defined

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investment climate as the set of location specific factors shaping the opportunities and incentives for firms to invest productively, create jobs, and expand. Assessing the policy, legal, and regulatory environment is important because small firms do not have the managerial and monetary resources to deal with complex procedures, frequently variable monetary and fiscal policies (ILO, 1998). Beck et al. (2005) stressed that the focus of the business environment view is on the environment facing all businesses, large and small. Dethier et al. (2010) indicated that the business environment affects the economy through its influence on incentives to invest and by inflicting pressure over firms that were previously enjoying some sorts of protection. For the previous reasons, Schiffer (2005) stated that the World Bank's strategy for promoting small firms has its focus to promote the establishment of business environments that give equal opportunities to all entrepreneurs independently of their size. Dethier et al. (2010) defined the business environment in terms of physical infrastructure, access to finance, security (absence of corruption and crime), and the regulatory framework. Porter (1990) underlined the role of business environment and offer a definition based on combination of four dimensions factors conditions, demand conditions, the presence of the related and supporting industries and the sophistication of company.

The four areas have collectively become referred as the Diamond. The section continues describing the concept of business environment applied in the research starting from a theoretical description of neo-institutional and regulation theories and also strategic management theories with Porter Model described in the next session.

3. Background: Literature review

3.1. The Foundations of the Theories of Endogenous Growth and Conditional Convergence justifying governance system and quality of institution in environment of doing business performance

The theoretical justification of doing business environment is based on the quality of institution in governance process, the institutional environment and regulations policies, the historical institutional path-dependence as main factor explaining economic growth and playing major role in doing business environment development.

3.2. Institution and endogenous economic growth

Many endogenous economic growth theories offered main factors including institution advanced by Douglass North (1990) which stressed the importance of institutions and its impact on economic growth by guarantying intellectual property right and reducing transaction costs (Coase, 1998) and thus increasing growth. The institution is playing a role in determining the growth and how they affect key factors and facilitate the coordination of decisions of private agents. According to new institutional economics theory pioneered by North (1990), institutions are there to reduce transaction costs. Inefficiency of bad institutional frameworks and the influence of institutional environments on economic growth and development are very important. In fact, public action is needed to correct market failures (externalities, market power, capital market failures) and to guarantee the provision of public goods. Indeed, market failures reflect a mismatch between the structure of private and social benefits; and in the industrial policy context, they may be associated with positive externalities and informational asymmetries. This situation implies that private investments will be lower than their socially desired levels. And due to the existence of market failures and the need to build states which can support market, particular institutional reforms need to be included to : achieving and maintaining stable property right, maintaining good rule of law and contract enforcement, minimizing expropriation risks, minimizing rent-seeking and corruption, achieving transparent and accountable provision of public goods, etc. (UNCTAD Report, 2009). The public intervention is important as part of doing business improvement through better quality of institution.

3.3. The Role of Institution in the industrial Policies in the neo-institutional and regulation theories

3.3.1. The role of institutional environment

The recent theoretical and empirical growth literature has suggested a wide range of variables as determinants of growth, one of them being the role of institutions. In fact, institutions, specifically the quality of institutional environment can explain why some countries are well developed and others are developing or less developed (Rodriket al., 2004). The societies that encourage investment through the means of incentives and high quality institutional environment will be richer than the others (Acemogluet al., 2002). A complementary relationship between market and public sector is needed due to the fact the market mechanism alone cannot function efficiently without a complementary public sector (Rodriket al., 2004). And how it is important to changing the policy environment to increase economic growth, as policies that do not operate in an institutionally disembodied environment (North, 1990). Institutions and incentives for coordinating change is also needed. It is stressed the interaction of policies and institutions that design the incentives structure which impact economic change. And the state, through public policy, can shape the structure of interactions through the provisions of incentives. Thus, incentives and institutions present the main coordinating devices for economic activities. Incentives as a package of rules which governing the exchange of goods and services, coordinate activities of economic and productions agents. Indeed, due the existence of market failures as imperfect credit, information, equity and insurance markets coordination failures, The role of the state is essential for creating the right set of incentives for investment, through regulating prices and through sectoral policies to promote technical change and fiscal policies(Khan, 2008).

Lee & Mathews (2010) on the other hand, underline that especially high-performing and economically successful countries managed to use their institutions for the benefits of economic growth, and the state became supportive for the economy that was seeking cooperation with the market. Therefore, argue that the lower of the government's capabilities, accountabilities and commitments, the lower sophistication of economic policies that the government can be trusted with (Keesing & Lall, 1992).

Where some pre-conditions are not present, and the risk of political capture is too high, it many necessary to focus on accountability enhancing measures and the promotion of a business-enabling environment (Kaufman & Krause, 2009). In addition, public policy needs to be harmonized and be compatible with an appropriate business environment. It is need reforms that improve the business environment by reducing legal, institutional and regulatory constraints for doing business and promoting better investment climate environment.

3.3.2. The path dependency of institution:

Disparities still exist between developing countries in terms of institutional development. Acemogluet al. (2002) & Nagy (2002) refer to the examples of some economies based on their argument of unsuccessful institutional development. The problem is the initial conditions and historical path-dependency of institutions. These factors can largely explain disparities between developing countries. North (1990) asserts that institutional evolution is the prerequisite of economic growth and depends on some specific determinants, which ensure context-specific characteristics of transformation of institutional frameworks over time. Many studies in the literature analyses the many success stories of countries as well as the unsuccessful ones. They refer to the role of the institutions quality and the role of institutions path-dependency. In fact, differences in economic performances of states can be explained by the performance of formal and informal institutions within the specific regional, social and historical contexts. In addition, institutions are endogenous to economic development, because the latter starts with institutional change aiming at getting the right institutions in place. It is a need to adapt them to economic changes and the new circumstances and environments (Tridico, 2011). Hodgson (1995) analyzed the evolutionary change of institutions and stresses that institutions are path-dependent and endogenous.

Moreover, the change of formal and informal rules and regulations always comes first before the other transformations that take place. Rodriket al. (2004) stressed the importance of property rights and rule of law as the prior rules relying on the context specificity depending on the historical trajectories, geography, political economy and other. At the same time, there is need for an institutional evolutionary process, which will encourage consistency between formal and informal institutions.

Formal market institutions should take into account the historical past and values of the country. It is very important to introduce government interventions in the economy in a form of gradual process of adaptation. In this respect, incremental building up of an informal institutional framework, taking into account existing business culture of the society, should be a prerequisite for economic transition. Developing countries, which were previously disadvantaged, have a possibility to catch up with the others if they implement the appropriate institutional reforms.

The major emphasis must be put on prevention that is, on reforming economic policies, institutions, and incentives and offering an appropriate legislation, etc. Developing countries need to focus on the improvement of formal and informal, static and dynamic institutions as a basis of catching-up for more competitive policies.

The formation of specific informal institutions, which comprised characteristic social norms, values, beliefs and behaviors of the society, influenced the development of business culture and attitudes towards formal institutions. Informal institutions prove to be important ground for the development of effective institutional frameworks. Stiglitz (1999) supports the need for the development of social and organizational capital and social norms and mentality for the transition period.

3.3.3. The institutional arrangement and the theories of economic regulation: the appropriate regulation of business environment

The excess if regulation of the business environment is identified among the key obstacles to growth in many developing countries (World Bank, 2008). Indeed, regulation can be thought of as a set of rules that constrain the actions of economic agents (Loayza, Oviedo, & Servén, 2010). Issues such as informational asymmetries, economies of scale in production, incomplete markets, and externalities may contribute to the existence of market failures. Otherwise, when market fail, government could correct those market failures through regulation (Pigou, 1960). Djankov et al. (2003) states that courts around the world are often highly inefficient, politically motivated, slow and even corrupt as well. In addition, it is important to stress how social relation and capital play an important role in institutional arrangements. The presence of non-coordinated decisions under a framework of imperfect information call for institution to reduce discretional decisions (Alonso & Garcimarti, 2010). Inefficient institution are existing of several agents interests are not limited. The appropriate institutional design can be based on different arrangements as an optimal combination. In many developing countries, regulation is excessive and is frequently associated with public officials that may abuse their power (Schleifer, 2005). It is important to facilitate the procedure especially be focused on competition and market discipline need more efficient.

In addition, the impact of business regulation is also arises from its effects of the creation and growth of firms (Loyaza et al., 2010) and stressed the importance of main areas of a firm's activity that are subject to regulation as part of the business environment: ease of firm entry, access to credit, property registration, contract enforcement, obtaining construction permits, getting electricity, tax, and trade regulations along with variables capturing the macroeconomic stability, physical infrastructure, and the countries' ability to innovate and cooperate.

In developing countries, the governments should play a supporting and facilitating role for the economy, through the introduction of special financial incentive schemes for business development, simplification of permits and licenses attainment, protection of physical and intellectual property rights, increasing enforce ability of laws and regulation policies. Thus, institutional framework becomes a system of determinants of building-up and development of economic actors.

3.3.4. Theoretical justification with the new strategic management theories: Porter Model

Porter's approach through the analysis of the competitive advantage of nations allowed justifying the role of the State to promote the competitiveness of firm's environment. These depend on the environment in which it operates and can be conditioned to grow. Indeed, Porter (1993) proposed a series of basic conditions that influence the performance of the economy in general and businesses in particular. Through this approach, a series of new measures in the environment of doing business found justifications. These measures are under the influence of the state on the determinants of the Porter diamond. The influence on the determinants of national competitive advantage was through a set of measures such as subsidies, education, and financial incentives, etc.

State also intervenes at the request by the policies that induce regulatory requirements found buyers. In the same time, the state is also a major customer for certain products. In addition, government policy also affects the fourth determinant that is the strategy, structure and rivalry of the companies through the regulation of capital markets, tax policy and competition law, it affects further upstream industries related.

All these actions are the subject of public policy measures that will be discussed in the following. Porter's work combined many dimensions of the national business environment into one integrated framework as factors conditions, the quality of local demand conditions and the presence of the related and supporting industries, (Porter, 1990). The four areas have collectively become referred to as the Diamond.

Firstly, Factor conditions have long been seen as affecting company creation and productivity. One of the main determinant is the quality of administrative practices, such as low costs of starting a business, is an input to business productivity and new business formation (Branstetter et al. 2010). Company productivity is also related to the set of incentives and rules that govern local competition. High levels of competition on local markets are important for high performance (Porter & Sakakibara, 2004). As many others determinants as physical infrastructure, efficient access to capital, quality of training and educatin, policies supporting innovation, etc. In addition, the ownership structure of companies is another important influence on the health of rivalry (Megginson & Netter, 2001).

Secondly, demand conditions, stringent local regulation that anticipates future changes and opportunities in other markets can encourage companies to innovate and build profitable international market positions. These new regulatory induced technological opportunities can provide direct productivity benefits (Esty & Porter 2005; Porter & van der Linde, 1995).

Another dimension of the business environment that directly influences companies' productivity is the presence of clusters of related and supporting industries as geographic agglomerations of companies, suppliers, service providers, and associated institutions linked by externalities and complementarities of various types (Porter, 1998).

In addition, the quality and sophistication of company operations and strategies of enterprises operating in a country (Porter, 1996). Many analyses reveal significant differences in managerial sophistication even across countries with broadly similar institutional and business environments (Porteretal. 2007).

Globally, Diamond pillars are containing main determinants impating productivity and growth and are directly linked to quality of administrative practices, incentives and rules governing local competition, associated institutions linked to clusters and supporting industries, etc .

4. Comparative performance in south Korea environment of doing business

An outlook of environment of doing business in South Korea is important and is based on performance outligning the role institutional framework, quality of institution, competition framework, etc. In terms of environment of doing business and competitiveness, South Korea are ranked as one of the best in the world in the position 4 in 2015. Due to the fact that South Korea has implemented a huge of reforms. Many reforms were selected in South Korea due to the extensive gaps in conjunction with significant barriers to entrepreneurship and a general control by the state, the targeting of certain reforms, etc. Indeed, reducing regulatory burdens across the whole economy is needed. The recommendations made in this area regarding the lifting of barriers to entry and exit of enterprises, improvement of regulatory transparency, reducing the control exercised by the state and strengthening the competition framework. In fact, many reforms during the period (2013-15) are done as: removing barriers to entrepreneurship by reducing costs and legal barriers to entry, improving the transparency of the regulation and reduction the fragmentation of regulatory framework, strengthen the competition framework, reducing barriers to foreign direct investment and to trade. New regulatory reforms and measures is to create an attractive business environment remain essential, particularly to strengthen the direct investment stock abroad (OECD, 2015). Improve the efficiency of taxation by making greater attention to indirect taxes promote growth.

In terms of priority, reducing the regulatory burden on the Korean economy also a priority. Regulations restrictive product market hinders competition, slowing innovation and productivity gains. Legislation enacted in 2014 limited the load regulatory imposing the removal of an existing rule whenever a new is adopted. A global fund was created in 2014 to encourage Foreign investors in venture capital to invest in Korea. Nevertheless, the authorities had taken a step back in 2013, by imposing restrictions on the entry of large companies in a number of areas of activity, which are now reserved to small and medium enterprises. Most of the recommendations are focused on reduce barriers to foreign direct investment and improve the business climate by enhancing the transparency of fiscal policy and regulatory, to attract foreign investors. Phase out barriers to entry of large companies in the areas of activity reserved for SMEs.

Others main priorities for South Corea are improving the efficiency of the tax system by giving more weight to taxes indirect. The tax burden is low but the tax system may become more favorable for growth. In 2016,the Republic of Korea made paying taxes more complicated and costly for companies by requiring separate filing and payment of the local income tax and by increasing the rates for unemployment insurance and national health insurance paid by employers. And in 2015, the Republic of Korea made transferring property easier by reducing the time needed to buy housing bonds and to register the property transfer.

The Republic of Korea strengthened minority investor protections by increasing the level of transparency expected from companies on managerial compensation. In 2014, Korea revised its secured transactions framework by creating new types of security rights that can be publicized through registration. And others reforms are done from 2009 to 2012 linked to labor market regulation, trading across borders, paying taxes, starting a business, resolving insolvency, enforcing contracts, etc.

According to the report of World Business, the rank of the facility of doing business is 4 and to protecting minority investors is 8, enforcing contracts is 2 and resolving insolvency is 4.

<Table 1> Korean Reforms diagnostics(2013-2015)

Reforms	Evaluations (2013-15)
Remove barriers to entrepreneurship / reduce costs and legal barriers to entry	x
Lighten exit procedures corporate / bankruptcy	
Simplify delivery systems permits and authorizations / paperwork	
Improving the transparency of reglementation / reducing the ragmentation of regulatory framework	x
Strengthen the competition framework	x
Reduce the presence capital / State intervention	
Improving governance of public enterprises	
Set up an impact assessment procedure in regulations or extend its application if it already exists	
Mitigate the rigor of environmental regulations	
other network industries	
Reduce barriers to FDI	x
Reducing barriers to trade	x
Promote the adoption of trade facilitation measures - reducing transaction costs	

Source: OECD(2015).

<Table 2> Reforms in South Korean economy:

Reforms (2004-2015) : 17			
Creation of companies	2	protection of minority investors	1
granting of building permits	1	payment of rates and taxes	3
connection to the electricity	0	border trade	1
transfer of ownership	2	enforcing contracts	0
obtaining loans	2	Insolvency regulations	0

Source: Doing business(2015).

<Table 3> South Korean business environment reforms(2009-2016)

Reforms per years	2009	2010	2011	2012	2013	2014	2015	2016
Enforcing Contracts				x				

Source: Doing Business(2016).

<Table 4> Doing business index in South Korea(2015)

Economy	Korea, Rep.	Getting Credit	42
Ease of Doing Business Rank	4	Protecting Minority Investors	8
Starting a Business	23	Paying Taxes	29
Dealing with Construction Permits	28	Trading Across Borders	31
Getting Electricity	1	Enforcing Contracts	2
Registering Property	40	Resolving Insolvency	4

Source: Doing Business(2015).

<Table 5> South Korean Economic freedom index(2014-15 change)

Strengthen		Limited change	
Rule of Law		Limited government	
Property right	75.0	Government spending	67.9
Freedom from corruption	55.0	Fiscal freedom	72.5
Regulatory efficiency		Regulatory efficiency	89.7
Labor freedom	51.1	Business Freedom	
Monetary freedom	81.6		
Open Markets			
Trade freedom	72.6		
Investment Freedom	70.0		
Financial Freedom	80.0		

Source: Freedom house(2015).

South Korea's economic freedom score is 71.5, making its economy the 29th freest in the 2015 index. Its score is 0.3 point higher than last year, with the improvement in property right, labor freedom, monetary freedom exceeding declines in the management of government spending and business freedom.

Since 2013, a well-functioning model legal framework ensuring strong protection of private property rights. The rule of law is effective and the judicial system is independent and efficient explain one the main key success of South Korean economy. Concerning regulatory efficiency, the competitive regulatory framework facilitates business formation. With no minimum capital required incorporating a business takes three procedures and four days on average. Otherwise, foreign investment in some sectors is regulated and the financial system has become more sophisticated and competitive, offering a wide range of options. But business start-ups and small and medium-sized companies struggle to obtain timely financing. The banking sector remains largely stable.

5. Recommendations

Typically, a south Korean case is very important as model for others countries and where business environment reforms are designed to bring about several of the results:

- The formalisation of business is very important. Simplified business registration procedures or appropriate tax incentives encourage firms to register as formal business.
- The removal of trade barriers or savings from an efficient licensing and inspections process facilitate the use of new legal opportunities that allow firms to save money, leads to increased profit.
- The improvement of legislative or regulatory frameworks is very conducive to their business and become more productive by gaining more easy access to government services which increasing profitability.
- A business environment reforms can lead firms to expand their activities. And business environment reforms are expected to contribute to economic growth.
- To meet international benchmarks of efficiency, international norms and standards in areas such as property rights, corruption, bureaucratic quality, good governance, technical norms and safety standards. These challenges require policy reforms and transition policies to be put in place, in order to minimize adjustment costs.

6. Conclusion

This paper offer an overview about a typology of Korean environment of doing business in the period of globalization. During its evolution, the state is change by taking into account market failures justifications interventions. In addition, Korea economy has built its development based in many factors, capacities, capabilities and the allocation of many resources in a dynamic framework is analysed to understand the space of environment of doing business and the use of its measures. Many solutions are underlined through this paper how to improve environment of doing business by reducing: the institutionally disembodied environment, legal and institutional and regulatory constraints for doing business, fragmentation of institutional arrangement, low level of incentives and rules governing local competition and for investment, etc.

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