

**I. Impact of Performance Based Remuneration Systems on Productivity
Performance of Local Industries:
Korea's Experience**

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1.0 Korea's Economic Development

The economy of Korea is the third largest in Asia and the twelfth largest in the world in terms of nominal GDP as of 2006. In the aftermath of the Korean War, Korea's grew from being one of the world's poorest countries to one of its richest. From the mid to late twentieth century, it has enjoyed one of the fastest rates of prolonged economic growth in history. The nation's per capita gross national product has grown from only \$100 in 1963 to \$24,500 in 2007. This phenomenon has been referred to as the "Miracle on the Han River." The three decades of extraordinary growth that transformed Korea from one of the poorest agrarian economies to the 11th largest economy and exporting country in the world, culminated in its accession to the Organisation for Economic Cooperation and Development (OECD) on December 12, 1996.

In recent years, Korea's economy moved away from the centrally planned, government-directed investment model toward a more market-oriented one. Korea bounced back from the 1997 East Asian financial crisis and carried out extensive financial reforms that restored stability to markets. These economic reforms, pushed by President Kim Dae-jung, helped Korea maintain one of Asia's few expanding economies with growth rates of 10% in 1999 and 9% in 2000. The slowing global economy and falling exports account for the drop in growth rates in 2001 to 3.3% but in 2002 Korea pulled out a very respectable 6.0% growth rate. Restructuring of Korea's conglomerates (*chaebols*), bank privatisation, and creating a more liberalised economy with a mechanism for bankrupt firms to exit the market remain Korea's most important unfinished reform tasks. Although the growth slowed down in 2004, a promising 5% growth was achieved in 2006 due to popular demand for key export products such as HDTVs and mobile phones. Increasing trade with the People's Republic of China is expected to boost Korea to a leading position among Asia's developed economies. It is also expected to lead the world in penetrating Japan's trade barriers.

Korea relies largely upon exports to fuel the impressive growth of its economy, with finished products such as electronics, textiles, ships, automobiles and

steel being some of its most important exports. Although the import market has liberalised in recent years the agricultural market has remained largely protectionist due to serious disparities in the price of domestic agricultural products such as rice with the international market. As of 2005, the price of rice in Korea is about four times that of the average price of rice on the international market and it was generally feared that opening the agricultural market would have disastrous effects upon the Korea's agricultural sector. In late 2004, however, an agreement was reached with the WTO in which Korea's rice imports will gradually increase from 4% to 8% of consumption by 2014. In addition, up to 30% of imported rice will be made available directly to consumers by 2010 where previously imported rice was only used for processed foods. Following 2014, Korea's rice market will be fully opened.

At the start of the 21st century, predicting that the Internet would become an important factor in the global economy, the government sought to make Korea the world's leading IT nation in just 5 years. With public funds the government began to actively support Korea's native IT industry led by flagships Samsung Electronics and LG Electronics. Success was seen at home in the following years with the development of Digital Multimedia Broadcasting (DMB) and Wireless Broadband (WiBro) technology and abroad with Korea's IT products and services capturing market share in key sectors such as semiconductors. With this technological background, Korea has been termed one of the 'Next Eleven' economies and at its current rate is expected to be equal in size to the economies of the United Kingdom and France by 2025. In addition to its advanced IT infrastructure, the government is now beginning to invest in the robotics industry. With the aim of becoming the "World's Number One Robotics Nation" by 2025, there are plans to put one robot in every household by 2020.

^{[4][5]} There are other ambitious plans to expand or create other sectors of the economy including the financial, biotechnology, aerospace and entertainment industries.

1.1 Korea's Globalisation (Segyehwa)

Under the comprehensive policy theme of *segyehwa* (globalisation) the government took an active role in participating in international economic

activities through the Uruguay Round of trade talks through its launching of the World Trade Organisation and through its membership in the Asia-Pacific Economic Cooperation. The government's effort culminated in Korea's accession to the OECD in 1996 which seemed to signal its entry into the rank of advanced countries. The future path of the country depends upon how prudently the political leaders, the government, the business leaders, workers and the public manage the current economic crisis. Current account surplus had been maintained since November 1997 with the help of increased exports and decreased domestic demand. The foreign exchange rate has stabilised at near pre-crisis level and the stock price index has recovered from its lows due to the resumption of foreign capital influx. At the same time, series of liberalisation measures are starting to take effect, especially in the corporate sector.

There has been active Merger and Acquisition (M&A) activities between foreign and Korean firms and foreign participation in Korea's bond market has increased. It is important to keep in mind that these reform processes did not begin with the breakout of the 1997 financial crisis. Instead, they were already in the process of being implemented under Kim Young Sam's globalisation policy exemplified by Korea's membership in the OECD. Therefore, the consensus for reform has existed in minds of Korean people. Furthermore, the election of the President from an opposition party created an adequate political environment to implement change allowing reforms to take place at faster pace. With sound infrastructure for market economy in place Korea will once again become the economic center of Northeast Asia with ample opportunities for investment. Korea's rich human resources history of miraculous development and unyielding commitment to liberal democracy all attest to its potential to recreate a robust economy in the decades to come. Some basic facts about Korea for the year 2007 are shown in Table 1.1 as follows:

Table 1.1: Data on Korea's Economy in 2007

Population (millions)	48.46
GDP (billions)	US\$ 969.9
Real GDP Growth (%)	5.0
GDP (PPP) per capita (\$)	US\$ 12,742.51
Consumer Price Inflation (%)	2.5
Unemployment Rate (%)	3.2
Labour Force (millions)	24.22

Source : World Competitiveness Yearbook 2008

1.2 Korea's Competitiveness

In terms of competitiveness, Korea is ranked 29th in the Institute of Management Development (IMD) World Competitiveness Yearbook 2007 and had slipped to 31st position out of 55 economies. It is a worrying trend and the challenges faced by the Republic on competitiveness as identified in the World Competitiveness Yearbook, 2008 are:

- Restore entrepreneurship through more aggressive deregulation
- Cut corporate, income and property tax rates to stimulate consumption
- Promote smaller and efficient government and fortify fiscal health in preparation for rapid population ageing
- Achieve labour-management peace by abiding by laws and principles
- Nurture world-class talent and give full autonomy to universities.

2.0 Labour Market Liberalisation

The labour market environment in Korea in the past has been characterised as "rigid." The legal system awarded workers substantial job security by limiting redundancy layoffs and temporary labour contracts. The conditions and procedures of redundancy, layoffs which were not clear in many ways placed an obstacle to flexible market adjustment as economic growth slowed in the 1990s and also as the economy shifted emphasis from quantitative expansion to qualitative enhancement with greater emphasis on knowledge-intensive and high-tech industries. The need for sectoral reallocation and downsizing increased but businesses often found their ability to do so greatly restricted.

Liberalised union activity since 1987 has increased rigidity in the economy. In the late 1980s, the government failed to control the illegal practices of unions, sometimes resorting to selective intervention for political gains. Furthermore, market forces could not discipline industrial relations in large firms and *chaebol*, as most people in Korea believed that large firms will never go bankrupt. The "too-big-to-fail" expectation stemmed from a series of past industrial policies favouring large firms.

In particular, enterprise unions in *chaebol* became stronger and more militant, and dismissals became virtually impossible. The economic crisis of 1997 provided an opportunity to enhance labour market flexibility and restore market mechanisms. It is understood that there is a need for a more flexible labour market in which labour allocation and wage determination are efficiently governed through market mechanisms. The government has made several announcements stating that while unlawful layoffs will not be tolerated, economic restructuring will take precedence over job security. In February of 1998, the government passed legislation legalising redundancy layoffs and also relaxed the previously restrictive legal provision relating to manpower leasing services. Firms now facing labour demand can adjust employment more flexibly and at a considerably lower cost which is a major step toward economic recovery.

To form a consensus on labour-related issues, the Tripartite Committee was formed among the representatives of labour, business and government. The committee established rules for an equitable sharing of both economic and non-economic costs and attained public consensus for the restructuring. The committee accomplished an accord which contained a considerable number of measures to enhance corporate governance transparency and to increase unemployment benefits and labour market flexibility.

2.1 Korea's Labour Force Trends

Korea was known for having the world's longest working hours. In 1986 the Korean worker averaged about 54.7 hours a week. This situation was the natural consequence of the low wage system that necessitated extended hours and extra work to earn minimum living expenses. There were however, dramatic increases in wages in 1988 and 1989. Labour stoppages in the manufacturing sector coupled with a scarcity of labour led to 20% salary increases for workers in the manufacturing sector in 1988 and 25% salary increases in that sector in 1989. These increases later spread and increased wages across the entire economy by 18.7 % in 1989.

By 1989, some of Korea's economists were worrying about the effect that skyrocketing wages would have on the cost of domestic made goods and the consequent impact on export prices. The wave of market liberalisation along with the political democratisation since 1987 ignited strong and violent labour disputes as well as tremendous wage hikes which have far exceeded the rise in productivity. In the 1990s wage hikes averaged 18% annually. In addition to such excessive wage hikes, high financial costs, excessive administrative regulations on business activities and low social overhead capital investment have afflicted industrial competitiveness and entrepreneurship.

The situation was especially worrisome because the wages paid to workers in Korea's major competitors were growing far more slowly. Average annual household income is 39,013,596 won (USD42,108) as of 1Q 2007 (Korea National Statistical office). The percentage change in output per hour, hourly compensation, unit labour costs and related measures in the Manufacturing Sector among selected APEC economies for the period 2005-2006 as reported by the Bureau of Labour Statistics, Washington DC, are shown in the table below:

**Table 2.1 Labour Statistics of Manufacturing Sector in
Selected OECD Countries**

Economies	Output Per Hour	Employment	Total Compensation	Unit Labour Costs (USD)
USA	2.0	-0.5	3.4	0.5
Canada	-0.1	-1	1.0	9.0
Australia	0.3	-1.2	4.1	4.1
Japan	1.9	1.5	0.9	-8.4
Korea	10.8	-0.4	4.5	3.5
Taiwan	6.9	1.1	2.5	-1.3

Source : NEWS-Bureau of Labour Statistics, Washington DC, Feb. 28, 2008

From the table, it can be observed that Korea's total compensation growth of 4.5% is the highest amongst the more developed APEC economies. This high compensation growth had led to increasing unit labour costs of 3.5% which could have affected its competitiveness.

2.2 Selected Labour Force Statistics¹

Selected employment, labour force and productivity data and rank from the World Competitiveness Yearbook (WCY) 2007 and 2008 are presented below:

**Table 2.2 Korea's Competitiveness: Employment Indicators,
WCY 2007, 2008**

	WCY 2007		WCY 2008	
		Rank		Rank
EMPLOYMENT				
Total Employment in Millions	23.15	14	23.43	14
Percentage of Population	47.93	20	48.36	21
EMPLOYMENT-GROWTH				
Estimates: Percentage change	1.29	39	1.22	44
EMPLOYMENT IN THE PUBLIC SECTOR				
Percentage of Total Employment	3.57	4	3.55	3
UNEMPLOYMENT RATE				
Percentage of Labour Force	3.60	8	3.20	4

¹ Institute of Management Development, World Competitiveness yearbook, 2008

	WCY 2007		WCY 2008	
		Rank		Rank
LONG TERM UNEMPLOYMENT				
Percentage of Labour Force	0.03	1	0.04	1
YOUTH UNEMPLOYMENT				
Percentage of Youth Labour Force (Under the age of 25)	10.00	12	8.80	12
EMPLOYMENT BY SECTOR				
Agriculture (% of Total Employment)	7.9	28	7.7	28
Industry (% of Total Employment)	26.8		26.3	
Services (% of Total Employment)	65.2		66.0	
LABOUR REGULATIONS				
Labour Legislation (hiring/firing practices, minimum wages etc.) do not hinder business activities	3.24	45	2.06	54
UNEMPLOYMENT LEGISLATION				
Unemployment legislation provides an incentive to look for work	5.54	16	4.22	35
IMMIGRATION LAWS				
Immigration laws do not prevent your company from employing foreign labour	4.50	49	3.84	54
WORKING HOURS				
Average number of working hours per year (hours)	2,439	1	2,305	3
LABOUR RELATIONS				
Labour relations are generally productive	3.35	55	2.97	55
WORKER MOTIVATION				
Worker motivation in companies is high in your economy	5.33	33	5.70	30
INDUSTRIAL DISPUTES				
Working days lost per 1,000 inhabitants per year (Average 2003-2005)	23.23	37	22.47	38
EMPLOYEE TRAINING				
Employee training is a high priority in companies	6.02	24	6.89	11

**Table 2.3 Korea's Competitiveness: Labour Cost Competitiveness,
WCY 2007, 2008**

	WCY 2007		WCY 2008	
		Rank		Rank
LABOUR PRODUCTIVITY (PPP)				
Estimates : GDP (PPP) per person employed per hour (US\$)	19.78	34	21.64	32
LABOUR PRODUCTIVITY (PPP) GROWTH				
Percentage change of GDP (PPP) per person employed per hour	-0.51	34	3.74	18
COMPENSATION LEVELS				
Estimates : Total hourly compensation for manufacturing workers (wages + supplementary benefits) US\$	14.58	32	14.70	33
UNIT LABOUR COSTS IN THE MANUFACTURING SECTOR				
Percentage change	-5.60	2	-0.48	11
REMUNERATION IN SERVICES PROFESSIONS				
Gross annual income including supplements such as bonuses in US\$				
• Bank Credit Officer	40,200	35	40,200	36
• Department head	55,600		55,600	
• Primary school teacher	43,300		43,300	
• Personal assistant	25,800		25,800	
• Call center agent	12,900		12,900	
REMUNERATION OF MANAGEMENT				
Total base salary plus bonuses and long-term incentives, US\$				
• CEO	298,531	21	346,138	20
• Engineer	80,720		86,273	
• Director Manufacturing	146,517		152,424	
• Human Resources Director	111,349		137,186	

**Table 2.4 Korea's Competitiveness : Labour Force Indicators,
WCY 2007, 2008**

	WCY 2007		WCY 2008	
		Rank		Rank
LABOUR FORCE				
Employed and registered unemployed millions	23.98	16	24.22	15
	WCY 2007		WCY 2008	
		Rank		Rank
LABOUR FORCE				
Percentage of Population	49.65	26	49.98	28
LABOUR FORCE GROWTH				
Percentage change	0.99	33	0.99	36
PART-TIME EMPLOYMENT				
Percentage of total employment	8.97	31	8.80	32
FEMALE LABOUR FORCE				
Percentage of total labour force	41.71	40	41.67	39
FOREIGN LABOUR FORCE				
Percentage of total labour force	1.46	32	1.77	28
SKILLED LABOUR				
Skilled labour is readily available	6.35	11	4.26	43
FINANCE SKILLS				
Finance Skills are readily available	5.71	42	4.85	44

Table 2.5 Republic of Korea's Competitiveness: Availability of Skills, WCY 2007, 2008

	WCY 2007		WCY 2008	
	Scores	2007	Scores	2008
ATTRACTING AND RETAINING TALENTS				
Attracting and retaining talents is priority in companies	6.28	34	7.70	7
BRAIN DRAIN				
Brain drain (well-educated and skilled people) does not hinder competitiveness in your economy	5.89	19	5.11	27

	WCY 2007		WCY 2008	
	Scores	2007	Scores	2008
FOREIGN HIGH-SKILLED PEOPLE				
Foreign high-skilled people are attracted to your country's business environment	3.78	48	4.46	32
INTERNATIONAL EXPERIENCE				
International experience of senior managers is generally significant	4.26	49	4.32	48
COMPETENT SENIOR MANAGERS				
Competent senior managers are readily available	4.68	41	3.92	46

Note : For detailed labour statistics by the Korea Labour Institute, please refer to Appendix 1

From the WCY 2007 and 2008 data and rank on employment, labour and productivity, it can be concluded that there are many avenues that Korea had to relook in order for competitiveness to be enhanced. Recognising this, the Government had since 2005, instituted various reforms including labour market reforms.

2.3 Towards Wage Reforms

In 2005, the government proposed labour reform legislation and a corporate pension scheme to help make the labour market more flexible, and new real estate policies to cool property speculation. Moderate inflation, low unemployment, and export surplus, and fairly equal distribution of income characterise this solid economy. Since the Asian financial crisis of 1998, the Korean economy opened up quickly to the outside world and Korean companies were pressured to downsize their workforce due to low profitability and excessive debt ratios. Many companies which traditionally followed the Japanese system of life-long employment and seniority-based wages in a closed internal labour market switched to the performance-based system practiced in United Kingdom and the United States of America.

The financial crisis of 1997 was regarded as a sign that the current employment system needed fundamental revision (Kim and Kim, 2003). Employers argued that the labour market should be made more flexible to adjust their workforce according to sudden decreases in output during the crisis. They succeeded in persuading the government to review the labour laws to introduce the practice of layoffs. Employers also wanted to change the wage system so that worker ability and performance, rather than seniority, would determine wages. Companies admitted that the seniority-based wage structure which does not link wages to productivity and/or performance was affecting competitiveness as well as the financial situation of the company. The aging workforce was another factor that led to the call for the change in the wage system by employers.

It has now become socially understood in Korea that if a company is in a difficult financial situation it has to retrench some of its employees. As in the case of Japan, under the seniority-based salary system, senior employees with higher wages were more susceptible to being laid off. However, in Korea, it is the middle-aged worker who is faced with less employment stability because the overall dismissal rate is higher. A recent survey by a newspaper in Korea showed that Korea's management-level employees believe that actual average

retirement age is 47 (Ee-hwan Jung and Byung-You Cheon, 2003).

In the current economic situation, characterised by shortened life cycle of knowledge, companies need to continuously restructure to remain competitive. This would involve displacement of non-performing workers. The Government however is under pressure to provide social support to those who have been forced to leave their jobs and address the issue of an aging working population. This had created a conflict of interest between companies and the Government. There is a need for collaborative efforts between industries and the Government in such a situation. For the industry, it is urgent that they flexibly implement and pursue a performance-based wage system to resolve the management issues created by life-long employment.

To initiate this, there is a need for the Government to initiate provide administrative support and financial incentives to induce businesses to adopt such a system. However, the issue of mandatory retirement age needs to be first resolved before the performance based system can be successfully implemented. This would involve investment in training and retraining of retrenched workers so that they can be re-employed more easily into the labour market. An alternative would be to ensure the mandatory employment of middle-aged workers and extend their employment in a seniority based wage structure by introducing the “wage-peak system.”

This system adjusts the wage level of middle-aged employees lower in accordance with their productivity. This could bridge the conflict between labour and management. Different systems are being used in different situations to suit the needs of the environment. The mandatory retirement system is being used in Korea as a means of employment adjustment in a situation of congestive personnel management and under the pressure of wage costs within a closed internal labour market structure. It also implied that the labour unions could have tacitly agreed to this situation. Therefore there is indeed a trend towards the implementation of a wage system that is linked to productivity and or performance to enhance competitiveness and ensure employment stability.

2.4 Wage System in Korea: Employees Perspective²

Raising flexibility of compensation system is emerging as a big social issue as Korea is facing rapidly aging population and deteriorating corporate competitiveness. According to a survey conducted by Korea Labour Institute, highly educated and young employees prefer job-and-performance-based compensation to a seniority-based one. The survey also found that employees like to have multi-factor pay systems. The factors may include seniority, performance, and job value while the bonus may also be determined by performance of an individual, group or corporation. Based on the Survey of Workers' Perception on Compensation Scheme conducted by the Republic of Korea Labour Institute (KLI) in 2004, analysis was done on the areas of norms on compensation and work-related values that might impact workers' preference for a pay structure. These include workers ideal compensation scheme and type, the acceptable range of wage differentials resulting from different levels of performance, preference between individual versus group performance-based salary, willingness to trade off between better working conditions (including employment and working hours) and part of the salary, the acceptable range of such trade off and the desire to have a greater say in wage-related matters.

2.4.1 Preferences regarding the Pay Structure

In the survey, employees were asked to select one out of eleven categories of "What is the most important thing about work?" Of these, the intrinsic values are learning opportunities, variety, interesting work, job match and autonomy and the extrinsic values include interpersonal relations, promotion opportunities, working hours, job security, good pay and physical working conditions. Overall, it was found that job compatibility ranked first, followed by job security, human relations and salary. It is interesting to note that salary was ranked fourth.

Fairness was another important variable related with workers preference for a pay structure. To the question, "What would be the fairest standard when

² Adapted from research paper entitled Wage System in Korea: What do workers want? Kim, Dong-Bae, 2005

differentiating the amount of pay”? the response selections were living expenses (“necessity”), individual abilities and accomplishments (“equity”), and equality. It was found that majority of workers (63%) favoured “equity” indicating that the workers are prone towards being paid according to their performance. As for preference between individual and group performance-based compensation plans, workers who put greater value on “equality” are likelier to lean toward group performance based scheme while those who emphasise “equity” favours individual performance-based scheme.

The research also found that workers favour a comprehensive mix of criteria rather than a single criterion for determining both the base pay and bonus. Among the base pay determinants mix favoured by workers are seniority, performance and job value while for determining bonus, workers are attuned to the mix of individual, team, department and company performance. When faced with the risk of unemployment, workers entitled to competency or job-based pay schemes are more likely to give up a part of their salary than those who are covered only by a seniority-based scheme. Likewise, employees of a company with a team performance-based remuneration system show greater willingness to do so.

Work related values and the fairness criteria have a substantial impact on workers’ preferences for a pay structure. Specifically, workers who are highly educated, young or hold office/managerial positions are more apt to place a greater importance on intrinsic values and equity; factors that are directly correlated with a job-based or performance-based compensation scheme. The result from the study indicated the possible existence of sub-cultures among Korean workers and its reflection of the generation gap among workers. The fact that the young and highly educated are less disposed toward the traditional seniority-based compensation scheme spells possible conflict between the older and younger generations. The overall preference is still for group performance based scheme (62.8%) over individual performance (37.2%), indicating that the culture of collectivism still looms large in Korea.

2.4.2 Implications for a Better Compensation Scheme

Since the financial crisis, companies in Korea attempted to improve the pay structure by increasing the performance-based factors within the existing pay structure, the best example being the “annual salary system”. For individual companies, converting the current automatic pay raise scheme into a performance-based scheme will help ease the rigidity of the current pay structure. The prerequisite is that fairness must be ensured when evaluating performance. Responsibilities should also be allocated appropriately to allow equal opportunities for all individuals to make the best use of their skills and talents and adequate investment should be made to develop necessary human resources. Improvement in the overall work system should precede the move toward broader implementation of the performance-based pay structure.

Workers acceptance of a revised pay structure should be ensured by encouraging their participation in the process. No pay structure can be successful without the support from the workers. Listening to individual workers is important but if there is a representative group, sufficient discussion should be held with the group prior to implementing a new scheme. It should be noted that to encourage dialogues between the management and the workers on pay structure at the individual company level it is necessary to first promote labour-management dialogue at the national level. *(For the full research findings, please refer to e-Labour News No. 40; Wage System in Korea : What Do the Workers Want?, Kim, Dong-Bae, Research Fellow, Korea Labour Institute)*

3.0 Productivity Practices of Current SMEs in Korea

In 2005, the share of SMEs in terms of number of firms, number of employees, output and added value was 99.4%, 76.3%, 49.7%, and 51.6%, respectively. The share increased rapidly until 2000 but stabilised after that. (Table 3.1)

Table 3.1 The share of SMEs in terms of No. of Firms, Employees and Added Value in Korean Manufacturing (%)

		1980	1990	2000	2005
No. of Firms	Total	30,823	68,872	98,110	117,205
	SME	29,779 (96.6)	67,679 (98.3)	97,379 (99.3)	116,547 (99.4)
No. of Employees	Total	2,014,751	3,019,816	2,652,590	2,865,549
	SME	1,000,044 (49.6)	1,864,189 (61.7)	1,962,908 (74.0)	2,186,348 (76.3)
Output	Total	362,791	1,773,088	5,648,341	8,517,890
	SME	115,709 (31.9)	757,130 (42.7)	2,675,619 (47.4)	4,237,591 (49.7)
Added Value	Total	118,566	709,245	2,194,246	3,127,920
	SME	41,683 (35.2)	314,318 (44.3)	1,101,508 (50.2)	1,613,824 (51.6)

Sources: Korea Statistical Information System (KOSIS) Notes: Output and value added are in 100 million Korea Wons.

3.1 Recent Trends of SME's Productivity in Korea

Labour productivity growth in Korea's manufacturing industry is shown in Table 3.2 by firm size and industry for the period 1999-2003. The growth rates are different across firm size and industry and SMEs have grown as much as large sized firms to become a large part of the economy..

Table 3.2 Per Capita Added Value Growth (%) in Korean Manufacturing by Firm Size and Industry (1999-2003)

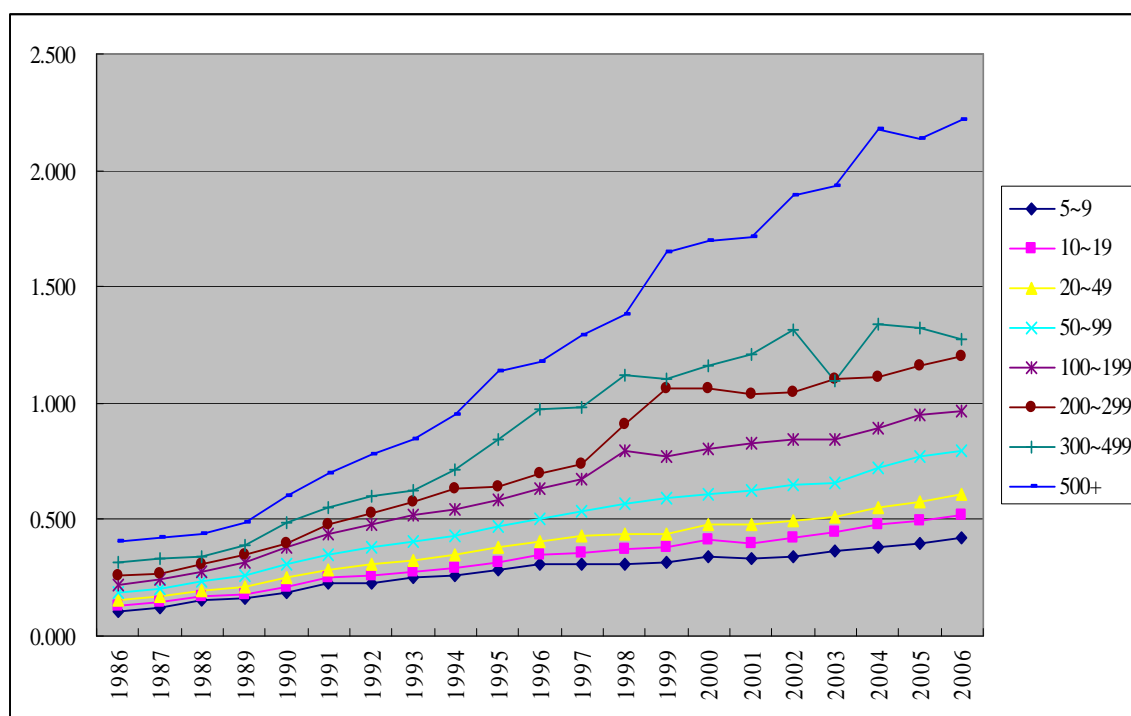
Industry	Total	5~19	20~99	100~299	300~499	500+
Total manufacturing	3.9	6.1	5.9	4.2	2.3	6.5
Food	0	7	3.7	-2.2	-4.5	7.8
Tobacco	4.2	-	21.7	7.3	-20.4	8.8
Textile	0.7	7.2	3.6	1.1	-7.5	-8.6
Clothing	12.2	7.2	14.6	13	12.1	19.4
Leather & Footwear	7.6	5	10.3	0.7	25.4	13.6
Wood	0.9	4.1	1.8	5.1	-	-7.1
Paper	2.2	4.2	2.5	3.8	11.3	1.6
Printing	2.7	5.3	4.4	8.8	9	-3.8

Industry	Total	5~19	20~99	100~299	300~499	500+
Oil	-5.7	-10.6	-0.1	36.8	-	-3.8
Chemical	5.9	4	4.9	10	2.5	11.2
Rubber & plastic	1.7	4.9	4.7	2.7	-3.1	1.6
Non-metal	6	8.6	7.5	8.6	5	5.7
Basic metal	6.8	7.6	5.9	2.5	11.8	10.6
Fabricated metal	2.4	4.6	3.7	1	-6.4	7.6
Machinery & equip.	6.1	6.9	5.9	6	6.4	12.4
Computer	1.5	7.7	5	-5.1	-6.4	3.9
Electronic machinery	2.2	5.4	6.3	0	3.5	3.6
Electronic parts	1.9	4.6	5.8	8.1	0.7	3.2
Medical & precision	3.8	5.7	5.9	0.7	16.3	10.9
Automobiles	9.5	6.1	6	8.9	5.6	12.4
Other transportation	1.7	11.5	6.2	-0.4	-13.1	3
Furniture	3.8	5.1	4.4	5.7	7.4	4.2
Recycled	5.9	7.2	4.4	-	-	-

Source : Kim (2005)

Labour productivity of SMEs was 45.7% of that of large firms in 1993, gradually decreasing to 38.4% in 1997, and only 33.1% in 2005 (Figure 3.1 and 3.2).

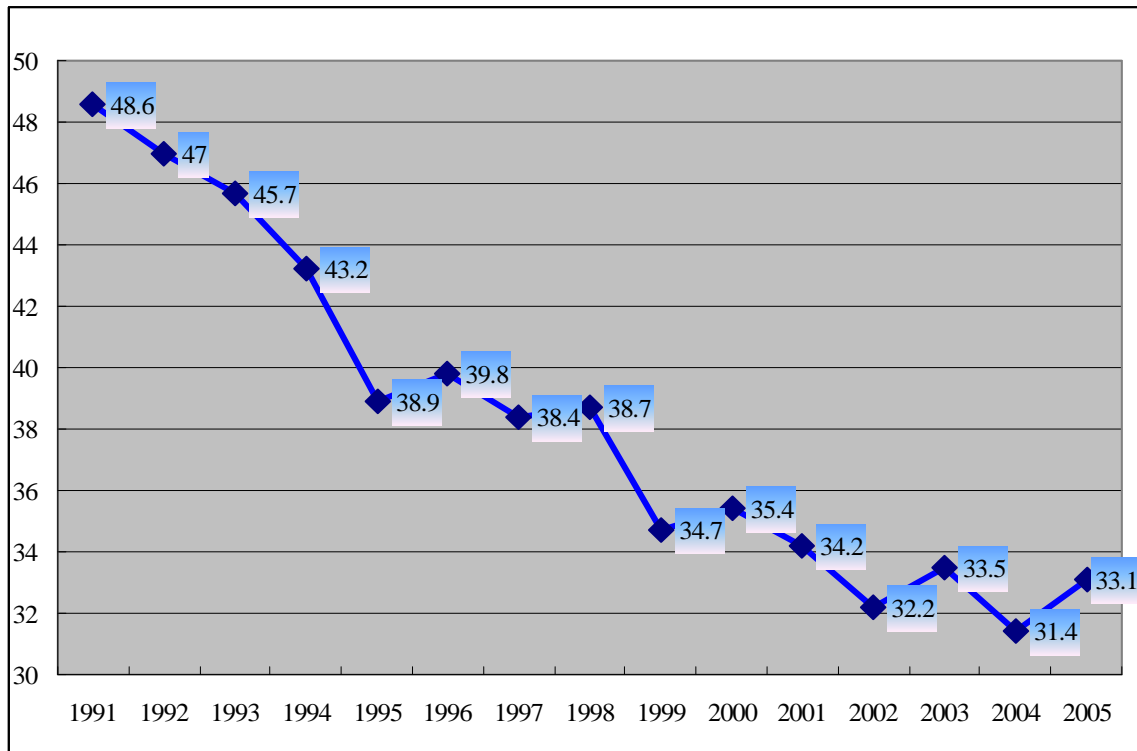
Figure 3.1 Labour Productivity growth by firm size in Korea (1987-2006)



Source : Korea Statistical Information System (KOSIS)

The ratio of labour productivity of SMEs to large firms dropped by about 20% in the earlier half of 1990s and was stable in the later half and it further decreased after the financial crisis in 1997. This continuous decline in the labour productivity was caused by slower growth of investments among SMEs.

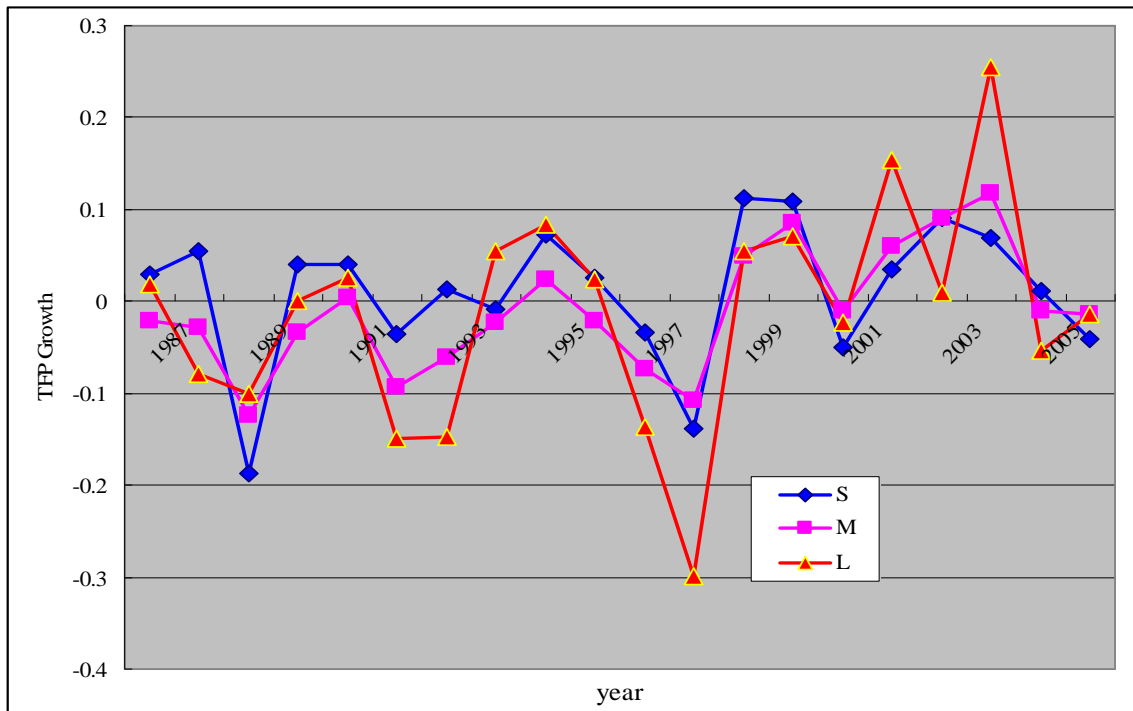
Figure 3.2 Change in the ratio of Labour Productivity of SMEs to large firms in Korea



Source: Ju and Cho (2006), p. 5

TFP growth in SMEs became much lower than larger firms after the crisis while TFP growth in SMEs was not slow compared with larger firms until the financial crisis. Thus, relatively low capital investment was the main reason behind the low labour productivity of SMEs and lagging TFP growth for Korean SMEs after the crisis (Figure 3.3).

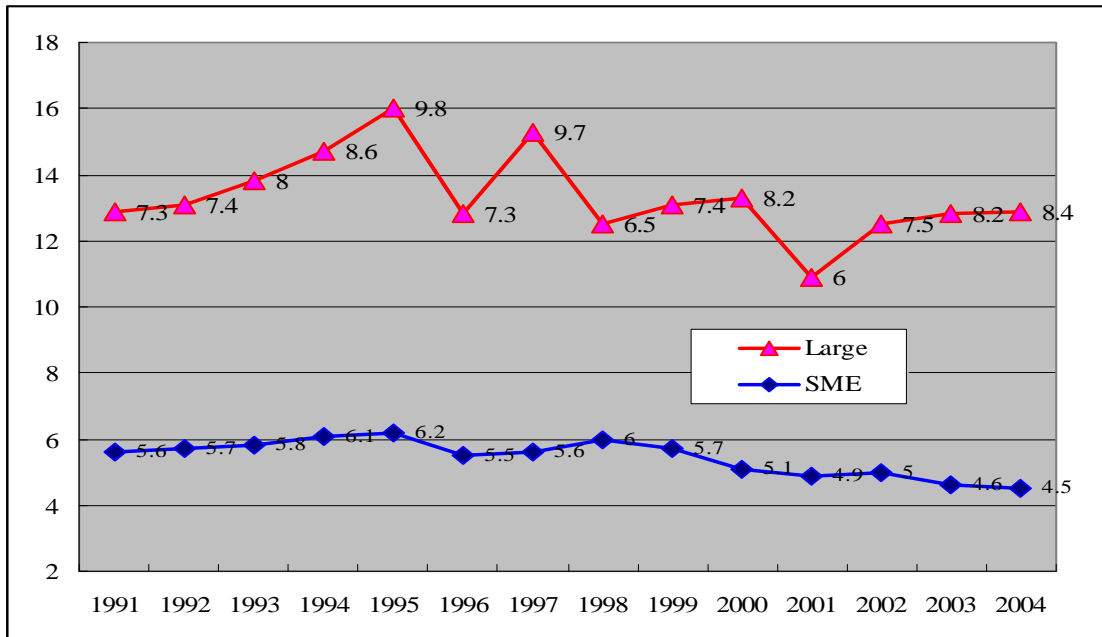
Figure 3.3 Evolution of TFP Growth by firm size in Korea (1987-2006)



Source : Computed from Korea Statistical Information System (KOSIS) data

Capital Accumulation in SMEs along with increasing labour cost lowered operating profits of SMEs in Korea which further deteriorated the profit of SMEs. In addition, slow investments were the result of off-shoring parts and components of large firms that took advantage of low wage of emerging economies, downward pressure of sub-contract supply price, and slow technological change due to low R&D investment.

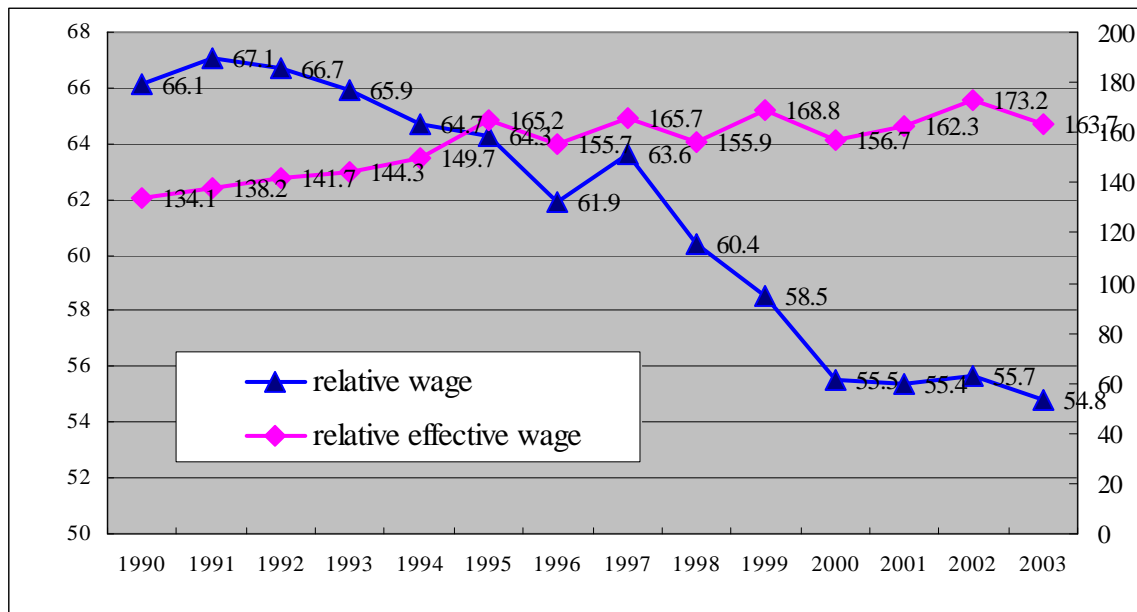
Figure 3.4: Changes in the ratio of operating profit to net sales by firm size in Korea, 1991-2005



Source : Cho (2005), p. 28

As a result, relative wage of SMEs to large firms (=100) slowly decreased from 66% in 1990 to about 55% in 2003. However, this decline in relative wage, cannot compensate for the even greater decrease in labour productivity, therefore, relative effective wage of SMEs to large firms (=100) jumped from 134 in 1990 to 164 in 2003 thus, deterring investments in SMEs. It is expected that the Performance-Linked Payment System will alleviate this burden for SMEs (Figure 3.5).

Figure 3.5 Changes in relative and relative effective wage rate of SMEs in Korea (1991-2005)



Source: Cho (2005), p. 31

3.2 Stylised Facts about SMEs in Korea

- **Capital Investment and Innovative Capacity**

After the financial crisis, capital investment had declined to a very low level that even affected the potential growth rate. This had especially hurt SMEs that lack financial resources. The lack of investment was the problem after the crisis, while over investment and over capacity was the problem before the crisis. The government should restructure the financial system to help SMEs to invest in production facilities. While creating new firms is actively pursued in Korea, this creation should be concentrated more on high value-added manufacturing industries as SMEs are currently concentrated in the declining traditional sectors, causing the problem of excess competition and excess capacity.

High-growing innovative SMEs should be promoted while low-growing SMEs should be restructured. Niche markets should be well defined for successful SME business. One of the initiatives is to be enhance the innovative capability of SMEs as this is would enable them to compete with other emerging low labour cost economies such as the CLMV economies (Cambodia, Laos, Myanmar and Vietnam). This requires cultivating new innovative SMEs

and enhancing innovative capacity of existing SMEs.

If innovative SMEs prosper, overall productivity of SMEs will increase. Thus, competitive market mechanism should be activated to encourage innovative SMEs to be established. However, the innovation capacity is related more with the firms' qualitative characteristics (firm's vitality, the leadership of CEO, motivation of employees) than quantitative ones (size, growth, profit rate, and history): Cho (1995), p.95. R&D investment of SMEs are less than 1%, compared to that of large firms which is more than 2% in 2003. Thus, innovative capacity remains relatively weak compared with larger firms in Korea (Table 3.2).

Table 3.2 Changes in R&D investment of SME and large firms in Korean Manufacturing

	Large firms			SMES		
	R&D Inv.	Sales	R&D/Sales (%)	R&D Inv.	Sales	R&D/Sales(%)
1997	4,467	286,322	1.56	814	129,130	0.63
1998	5,884	291,291	2.02	800	129,089	0.62
1999	5,333	301,295	1.77	767	163,240	0.47
	Large firms			SMES		
	R&D Inv.	Sales	R&D/Sales (%)	R&D Inv.	Sales	R&D/Sales(%)
2000	5,225	355,467	1.47	1,306	184,010	0.71
2001	5,429	357,140	1.52	1,819	183,693	0.99
2002	6,812	396,052	1.72	1,871	220,158	0.85
2003	8,448	18,224	2.02	1,901	243,768	0.78

Source: Cho (2005), p. 96

- **Adapting to Business Cycles**

As the Korean economy matured and becomes more technology-driven, SMEs often have to deal with restructuring problems. After the financial crisis, the

capacity utilisation rate of SMEs became much lower than the average rate of the manufacturing sector. SMEs have easier access to loans and invested heavily to deal with foreign competition during the boom before the crisis but they are the first ones to feel the financial pinch as banks cut back on their lending to SMEs during the recession after the crisis.

SMEs are generally slow to adapting to industrial restructuring as SMEs are operating in low profitable declining industries and therefore fail to move into more profitable rising industries. The industries in which SME's share is high are the ones in which profit rate decreased more (Table 3.3).

Table 3.3 Restructure of SMEs in Korea's Manufacturing Industries

	SME share			Share in total manufacturing		
	1993	2000	Difference	1993	2000	Difference
Food	10.1	11	0.9	8.1	7.2	-0.9
Tobacco	0.2	0.3	0.1	2	1.1	-0.9
Textiles	9.7	8.2	-1.5	7.1	5	-2.1
Clothing	5.1	3.4	-1.7	3.5	2	-1.5
Plastic	5.4	6.1	0.7	3.9	4	0.1
Sub total	42.7	38	-4.7	33.3	25.3	-8
Chemicals	9.5	11.2	1.7	9.9	9.5	-0.4
Non-metal	7.6	5.1	-2.5	5.6	3.8	-1.8
Basic metal	4.5	4.4	-0.1	6.9	6.3	-0.6
Fabricated	7	7.3	0.3	4.7	4.1	-0.6
Computer & office	0.8	1.1	0.3	0.9	3.3	2.4
E&E	3.6	5.5	1.9	10.5	17	6.5
Precision	1.6	2	0.4	1.1	1.1	0
Automobiles	4	4.9	0.9	7.8	9.4	1.6
Sub total	57.3	62	4.7	66.7	74.7	8
Total	100	100	0	100	100	0

Source: Yang (2002), p.60

- **Changing Size of SMEs in Korea**

There had been rapid increase in extremely small firms as reflected in the growth of firms with 5-19 employees. Firms who employ between 5-9 employees had more than doubled from 27,128 in 1992 to 58,379 in 2005, and that with 10-19 employees expanded from 21,288 in 1992 to 30,307 in 2005. However, firms with 50-299 employees decreased from 8,244 to 8,145 during the same period (Table 3.4).

Table 3. 4 Changes in firm-size groups in Korea's manufacturing industry

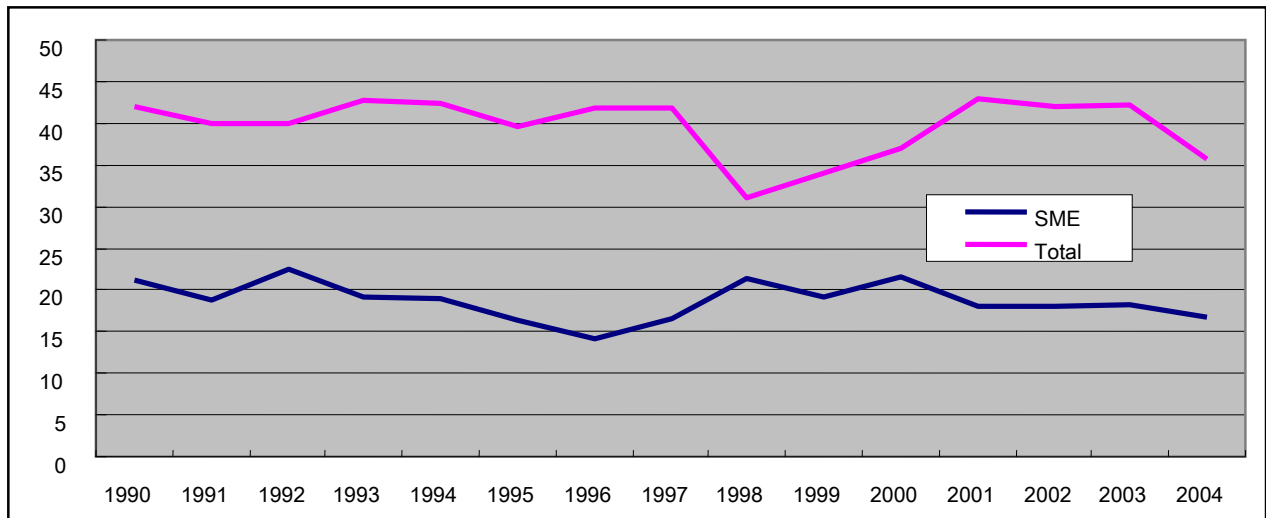
		No. of firms			No. of employees			Added value		
		1990	1996	2004	1990	1996	2004	1990	1996	2004
SME		98.3	99.1	99.4	61.7	69.2	75.7	44.3	47.2	49.4
Extra small	5~9	31.4	45.3	50.7	4.9	9.9	12.9	2.3	4.5	5
Small	10~19	29.2	27.1	25.3	9	12.2	13.7	4.7	6.2	6.7
	20~49	24.8	18.3	16.3	17.4	18.5	19.8	10.6	11.2	11.5
Medium	50~299	12.8	8.4	7.2	30.3	28.6	29.3	26.7	25.5	26.2
Large	300+	1.7	0.9	0.6	38.3	30.8	24.3	55.7	52.8	50.6

Source: Ju and Cho (2006), p.109

- **Internationalisation of SMEs in Korea**

To enable SMEs to expand their markets, there is a need to promote more exports among SMEs. As domestic demand had stagnated, SMEs need to sell more of their products in international market to sustain their growth. However, the share of SMEs in exports and the number of exporting SMEs had declined indicating that SMEs had to double their efforts to enter the challenging export market (Figure 3.6).

Figure 3.6 Changes in the ratio of exports to sales for SMEs in Korea (1990-2005)



Source: Cho (2006), p.41

- **Financial Support System for SMEs**

The current financial support system for SMEs is directed to improve “financial availability” and “financial accessibility” of SMEs as there is asymmetric information in the financial market that affects SMEs. Credit guarantee, business loans and investment financing systems are operated based on the government funds. Financial support for SMEs is implemented through various financial institutions, government agencies, local governments, public credit underwriters and national banks. Under the current system, many SMEs that have access to bank finance are also supported by SME financing which comprises entirely of indirect financing. As the size of SME financial support increases its adequate system is constantly debated.

4.0 Cases on Impact of Performance-Based Remunerations on Enterprises in Korea

4.1 Case A: Employee Evaluation System of Bohae Distiller Inc.

Bohae Inc. was founded in Mokpo, Jeonnam Province in 1950 which is located at the south western tip of the Korean peninsular with about a population of about 200,000. In 1935, the founder Mr. Lee, started a small wholesale business in Mokpo selling general merchandises such as household products and alcohol beverages. In 1945 his business grew and found a large trading company that dealt in seaweed, salt and alcohol. After the liberation of the Korean peninsular from the Japanese rule, he concentrated his business on alcohol trading and acquired a distiller in 1950 to establish K distiller, which preceded the current Bohae Inc.

Since then, the company has firmly established itself as a local distiller of various liquors and wines including soju, apricot wine and whiskey. In 1968, the founder built a factory that produced malt which is a major ingredient of soju that is the most popular Korean liquor with about 20% proof but the factory went bankrupt during the recession in 1978 and was put under court management. The local distiller was however, bailed out by employees efforts and support from the local population who wanted their favorite soju to be made by a local company. The soju market was then monopolised by dominant local producers competing with national player, Jinro Soju Inc. Royalty to Bohae soju was a main asset of the company to recover from the bankruptcy and maintain a huge market share of the local soju market with more than 90% throughout 1970s and 1980s.

In 1991, the company built a frontier distilling factory with capacity of 200,000kl in Jangsung, thus preparing for the second take-off. Currently, with the new facility and continuing introduction of new products, Bohae Inc. established itself as a strong medium local firm with total sales of about 130 billion Korean Won (about 0.13 billion USD). Bohae Inc. now comprises malt and food factory, trading, financing sub-companies, an educational foundation and produces soju,

wines, liquors and whiskey with total assets of 202.9 billion Korean Won (about 0.203 billion USD) with 469 employees. In 1994, the company started to export soju to Japan and export revenues totaled about 3.5 million USD in 2000. It expanded its export market to the US, China, Canada, Australia, New Zealand, and many East and South Asian economies.

Currently, Bohae Inc. has six affiliated companies including B&F, Bohae Apricot Farm, Bohae Mutual Investment Bank, Bohae Trading, Changhae Ethanol and Bohae Educational Foundation. B&F produces apricot beverages and the Bohae Apricot Farm supplies quality apricots to Bohae Inc. and B&F. Bohae Mutual Investment Bank provides banking services to small businesses and low income people and Bohae Trading was founded in 1989 to do international trade, mostly in alcohol beverages. Bohae Educational Foundation provides scholarships to students.

4.1.1 The Vision

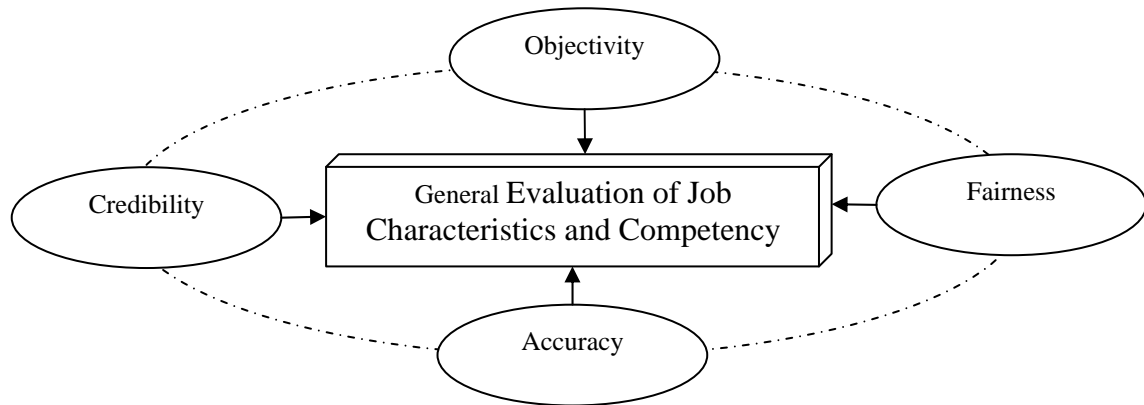
Bohae Inc. has a motto that says "To serve with sincerity, increase productivity, and develop with creativity." The company has a vision to develop a traditional alcohol brand of Korea that can compete with worldwide famous alcohol brands and do its best to internationalise soju. Its goal is to cultivate a new culture in the company, satisfy the consumers and serve the society.

4.1.2 Personnel Management Principle

- **Basic System of Personnel Assessment**

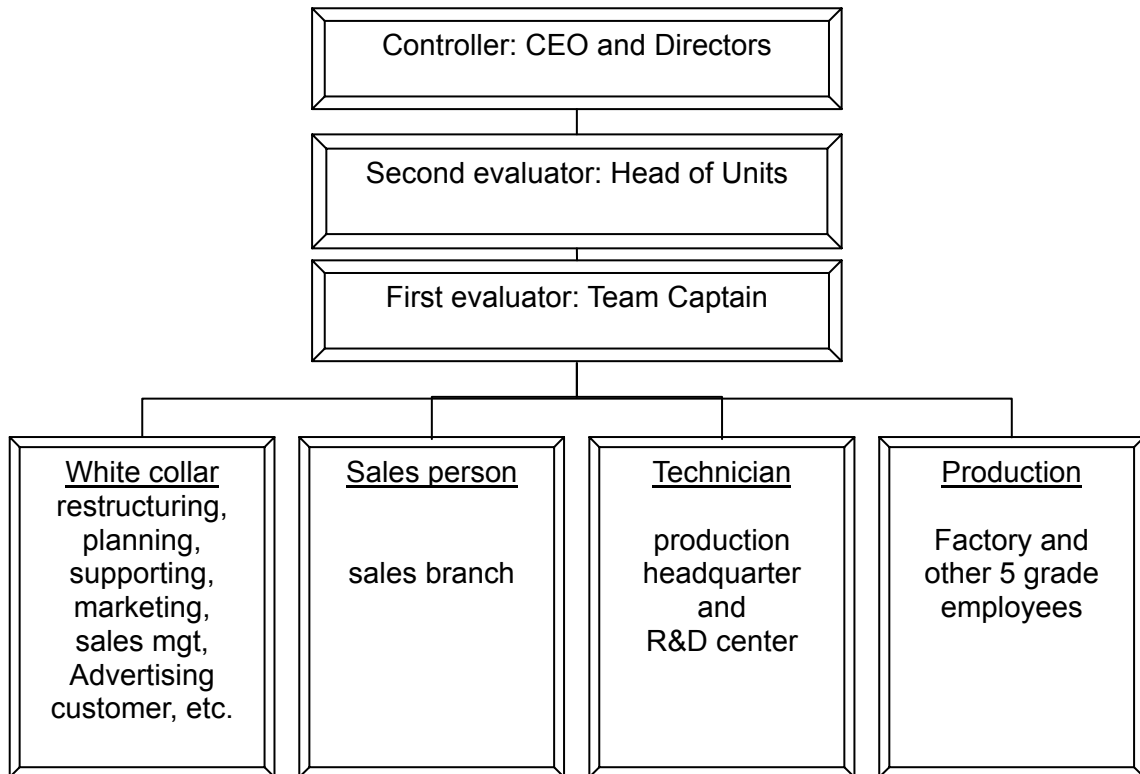
Bohae Inc. enacted a personnel assessment system in 1982 to evaluate employee's working attitude and achievement and linked it to promotion, bonus payment and job training. The company's assessment system has the following principles (Figure 4.1). The goal of the system is to evaluate general conditions required to achieve a basic job for every employee. The evaluation is based on official reports that are both accurate and fair, and implemented biannually in January and July.

Figure 4.1 Basic Principles of Personnel Evaluation



The controller of Bohae Inc. includes the CEO and board members and evaluations are implemented twice a year. For the evaluation of white-collar employees, evaluators including division chief manager, team captain and officers participate in the first assessment but there is no second assessment. For the assessment of sales person, branch manager and officers conduct both first and second assessments. For technician assessment, division and department head and officers evaluate only once, and for workers, department head and line operator are in charge of the first assessment, and division head and directors the second. Directors and CEOs become controllers in each case. Exceptions from the evaluation are acknowledged for new employees with less than three months experience, long-term absentees with more than three months leave and promoted employees with less than three months in the new positions. The basic personnel evaluation structure is as follows (Figure 4.2):

Figure 4. 2 Personnel Evaluation Structure



- **Development of Personnel Evaluation System**

The personnel evaluation system was introduced in 1982 and divisional assessment was implemented based on seniority merits, special merit and achievement evaluation in 1992. Competency evaluation was added to every job and rank but special merit was omitted in 2004. Director's discretionary adjustment was introduced in 2008 and self-development was also required to be incorporated in the report for evaluation. Work performance was evaluated based on mutually agreed goals between evaluators and employees through continuous communication. Evaluation of directors was added in 2008. The development of the system is summarised in Figure 4.3.

Figure 4.3 Development of Personnel Evaluation System

1982 -----> 1992 -----> 2004 -----> 2008 ----->			
Person in charge	Head of Personnel Department	Head of Personnel Department and CEO	Head of Personnel Department and CEO
Evaluation Items	Seniority merit Special merit Performance	Employed period Job attainment evaluation <ul style="list-style-type: none"> ▶ performance ▶ competence 	- Employment Continuance score - Job attainment score <ul style="list-style-type: none"> ▶ performance evaluation ▶ competence evaluation ▶ director's evaluation Self-development

Job achievement evaluation is based on five grades depending on the difficulty, quality and quantity of job. Competence and performance are weighted differently according to jobs. Table 4.1 shows the weights for final grading by job.

Table 4.1 Weights for Final Grading by Job in Bohae Inc.

Evaluation category	Office workers	Sales person	Technician	Production workers
Competence	50%	50%	50%	100%
Performance	50%	50%	50%	0%
Total	100%	100%	100%	100%

4.1.3 Specification of Evaluation Category

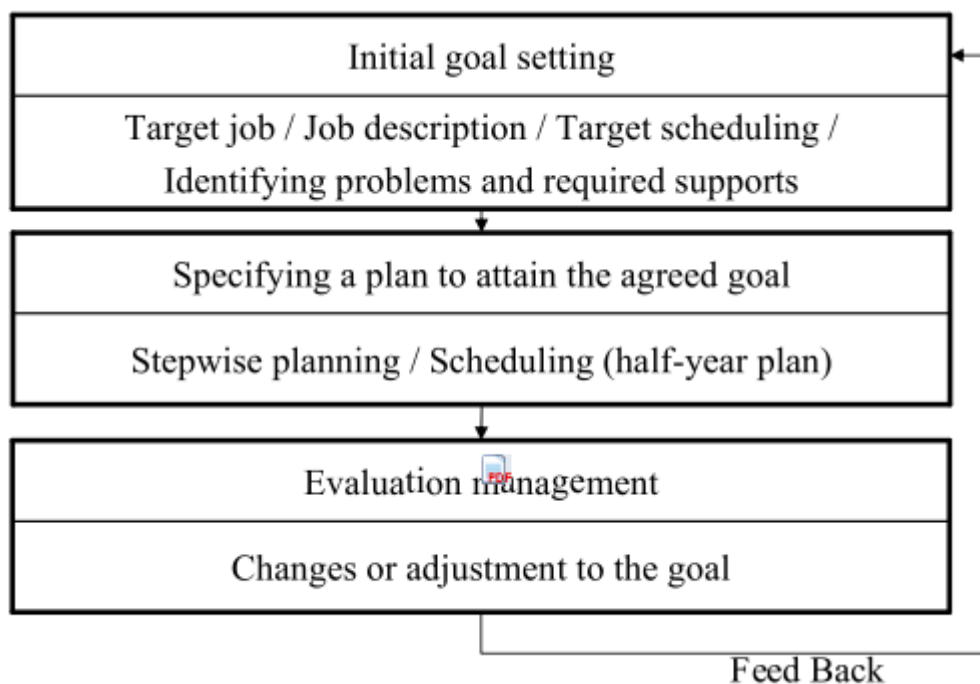
- **Seniority Merit**

Seniority merit gives 2-5 points according to 1, 2, 3 and more than 4 years and absenteeism, late reports, early departs and disciplinary actions are deducted. Employees who received awards, contributed to production increase and completed on-the-job-training are given additional points.

Performance Record

Performance record evaluation is classified into five grades according to work difficulty, quality and quantity, with varying weights to ranks. Competency evaluation comprises three factors of basic factor, job factor and organisational factor. The Director can adjust the total scores by considering two assessments within a certain margin. Job achievement and performance evaluation process is as shown in Figure 4.4:

Figure 4.4 Flow Chart of Goal Setting for Job Evaluation



Evaluation categories include basic factor, job factor and organisational factor and are specified as follows (Table 4.2):

Table 4.2: Competency Evaluation Specification

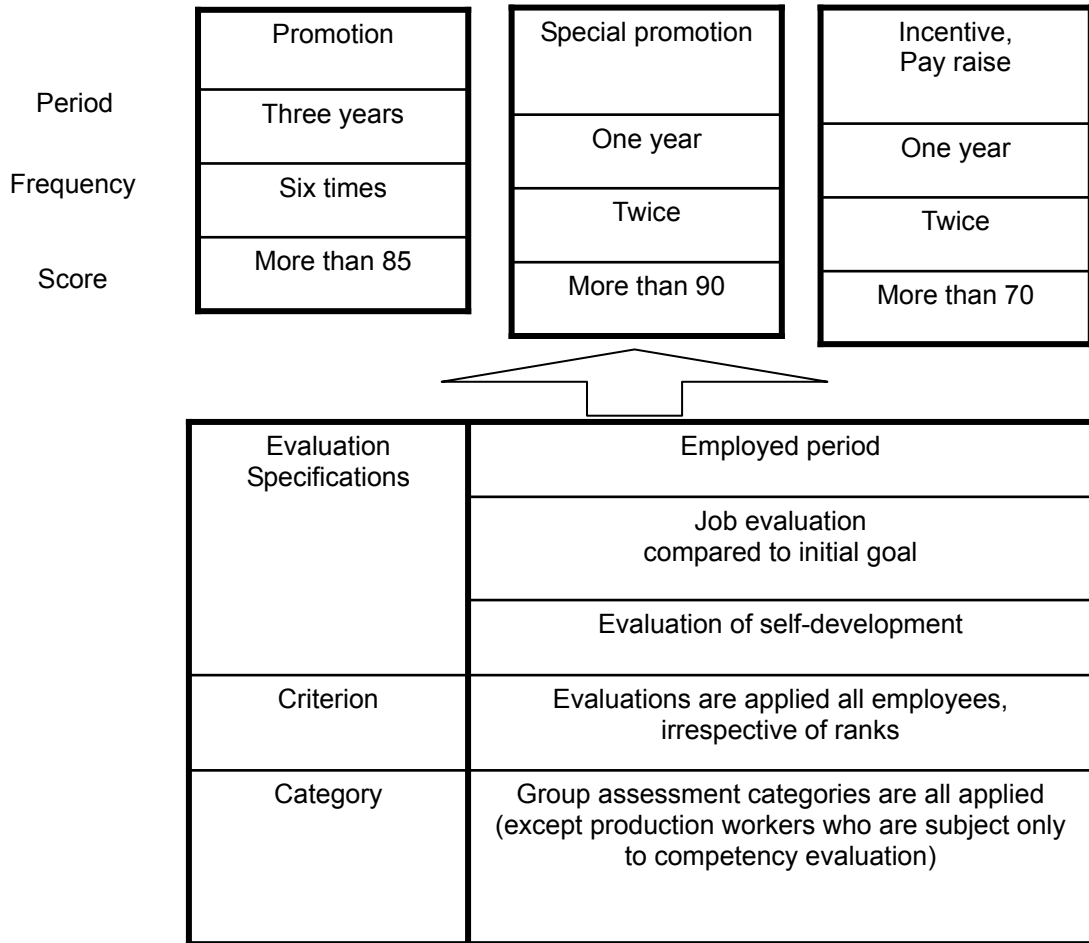
Category	Evaluation factor	Criterion
Basic Quality	Loyalty, Morality, Team spirit	Loyal enough to develop along with the company and moral enough not to pursue individual interest against company's. Does he/she have a good relationship with other employees?
	Managerial awareness	Aware of company's managerial knowledge and his/her role in it. Will he/she contribute to the company in the long run?
	Challenge minded	Adventurous and active enough to set goals and targets and willing to take risks under uncertainty to solve difficulties by him/herself.
Job Competency	Problem-solving ability	Active enough to solve existing problems for him/herself without help from others. Willing to suggest ways to achieve target to a team captain.
	Information gathering and utilisation	Collecting job related information like market trends, competition environments and managerial information, and analyses them to derive important task.
	Accounting and financial awareness	Try to learn accounting and financial knowledge and apply them to work.
	Job knowledge (for white-collars)	Continuously work to earn experience and acting knowledge to attain specialty required to job.
Organisational Competency	Learning	Participate educational program to develop him/herself and disseminate acquired knowledge to other employees.
	Idea suggestion and application	Actively provide issues and ideas to solve them in every area to improve job attainment.
	Communication	Try to keep intimate relationship with other employees and contractors.

The evaluation of self-development assesses job competency and placement, Evaluations are carried out by two evaluators and the controller provides the final grades.

4.1.4 Utilisation of Evaluation Results

Managers in charge of evaluation educate employees before every evaluation to implement the system efficiently. Evaluation is strictly confidential and is notified directly to the employees. Evaluation results are utilised in promotion and incentive payment. The following summarises its utilisation:

Figure 4.5 Utilisation of Evaluation Results



4.1.5. Impact of Evaluation System on Performance

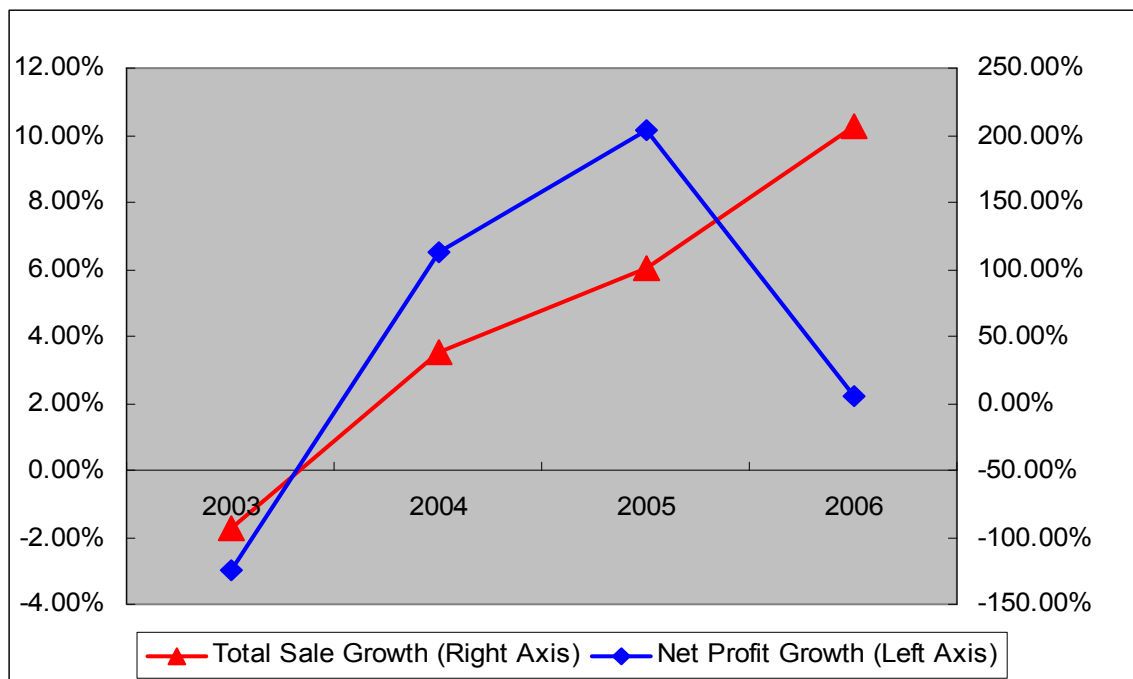
With the introduction of full-scale evaluation system in 2004, Bohae Inc. enjoyed increased sales and profit. Total sale of the company increased from 93.8 billion Won to 99.5 billion Won in 2005.

Table 4.3 Impact of Evaluation System on Performance in Total Sale

	2003	2004	2005	2006	2007
Total Sale (0.1 Billion Won)	906	938	995	1,097	1,267

The positive change is especially noticeable in Soju market as the sale of Bohae Soju, its Soju brand and main product reflecting about 60% of its total sales increased from 3.53% in 2004 to 6.03% in 2005 and the profit increased remarkably from 112.12% in 2004 to 203.78% in 2005 (Figure 4.6).

Figure 4.6 Impact of Evaluation System on Performance in Soju Market



4.1.6 Looking to the Future: Linking Payment to Performance

Bohae Inc. currently does not fully utilise the performance linked payment system but is trying to implement it within 2-3 years after noticing the impact of the evaluation system on productivity, according to a top manager interviewed. The company utilises performance evaluation system only, partially linking it to payment but it is very useful to understand that a local company tried hard to introduce an objective performance evaluation system itself. The company can still reap benefits with the introduction of the system. We have to consider that

the local company rooted firmly on the loyalty of local people is hesitant to link performance into payment especially when it is family oriented like Bohae Inc. The company provides a case that is on crossroads to link payment to performance.

4.2 Case B: Performance-Linked-Payment System of Harim Inc.

Harim Inc. started its business of a small chicken farm in Jeonbuk Province in 1978 and founded a food processing company in 1980. The company was later incorporated in 1990 and built the largest factory for hatching and processing chickens in Korea. The factory boasts the largest capacity even in Asia as it can process 300,000 chickens a day. In 1992, the company's products were accredited with KS (Korean Standard) from the Korean government for their high quality chickens and it was the very first time the certification was extended to farm and dairy products in Korea. In 1997, the stock of the company was listed on the Korean Stock Exchange. The company was later certified with ISO9001 and as a work place applying HACCP for its product quality and management excellence.

In 2003, Harim Inc. survived and recovered from a disastrous fire that burned its processing factory which was the greatest adversity in the company's history. In December of the same year the company was severely hit again by AI (Avian Influenza) that had spread rapidly through out the chicken farms and chicken farmers who were not prepared to cope with it. It was the first time AI broke out in Korea and the chicken industry in Korea was caught in deep depression as it had to dispose of large parts of its livestock and consumers turned away from chicken food. In 2005 however, the company prevented the epidemic greatly by the use of vaccine and other immune enhancing substances, environment-friendly farming equipment and improved waste processing systems, instead of using antibiotics.

Currently, Harim Inc. opened a research institute for bio-science to cooperate with a neighboring local university for both research and development and human resources development by granting scholarships to its students. The

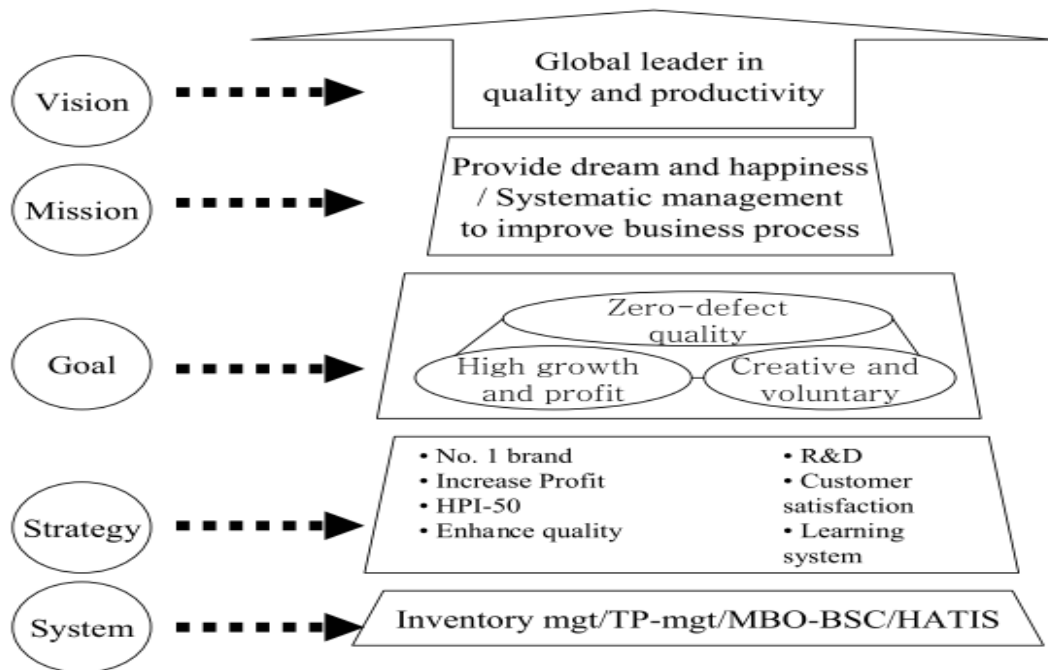
research institute is also pursuing 15 research projects that include a test medicine for cirrhosis, a health product from chicken liver, an anti-aging food and cancer preventing food products, and these projects were selected among applied researches from many university research centers throughout the country.

4.2.1 The Vision

Harim Inc. strived to be a global leader in quality and productivity, tried to build an organisational culture that provides dreams and happiness to its employees, and managed a system that can improve its business process efficiently. The company's goal is to be the best firm by ensuring zero-defect quality, going after high-growth and high-profits, making it the number 1 brand, improving quality and profit, and pursuing continuous research and development.

Harim Inc. wants to run an integrated management system in three areas of farm, factory and market (three-field management) by integrating farming, production and distribution to save cost and provide high-quality hygienic products to consumers. The company provides a vertical integration model of chicken processing business. The company provides a role model to compete with foreign firms based on stock farming that has been considered as small-size, outdated and uncompetitive compared to other global companies. Figure 4.7 depicts the vision, mission, goal and strategy and system of Harim Inc.

Figure 4.7 The Vision, Mission, Goal, Strategy and System of Harim Inc.



4.2.2 Business Divisions

Harim Inc. consists of three business divisions: farming (Division 1), fresh meat (Division 2), and processing (Division 3). Division 1 directly runs Grand Parent Stock, raising 50,000 chickens totaling 800,000 chickens a year under the technical support of special veterinarians. Division 2 operates the butchering factory that can process 350,000 chickens a day with waste and by-products processing and freezing facilities. Division 3 opened in 1997 and produces 100 tons of processed food in a day. Placed in Division 3 are frozen food production and supporting team, R&D team, education center, frozen/retort product, planning, computing and diplopic teams. As affiliated firms, there are C Forage, N Home Shopping, Food Catering Team and Food Company.

4.2.3 Harim Inc.'s Performance Linked Payment System

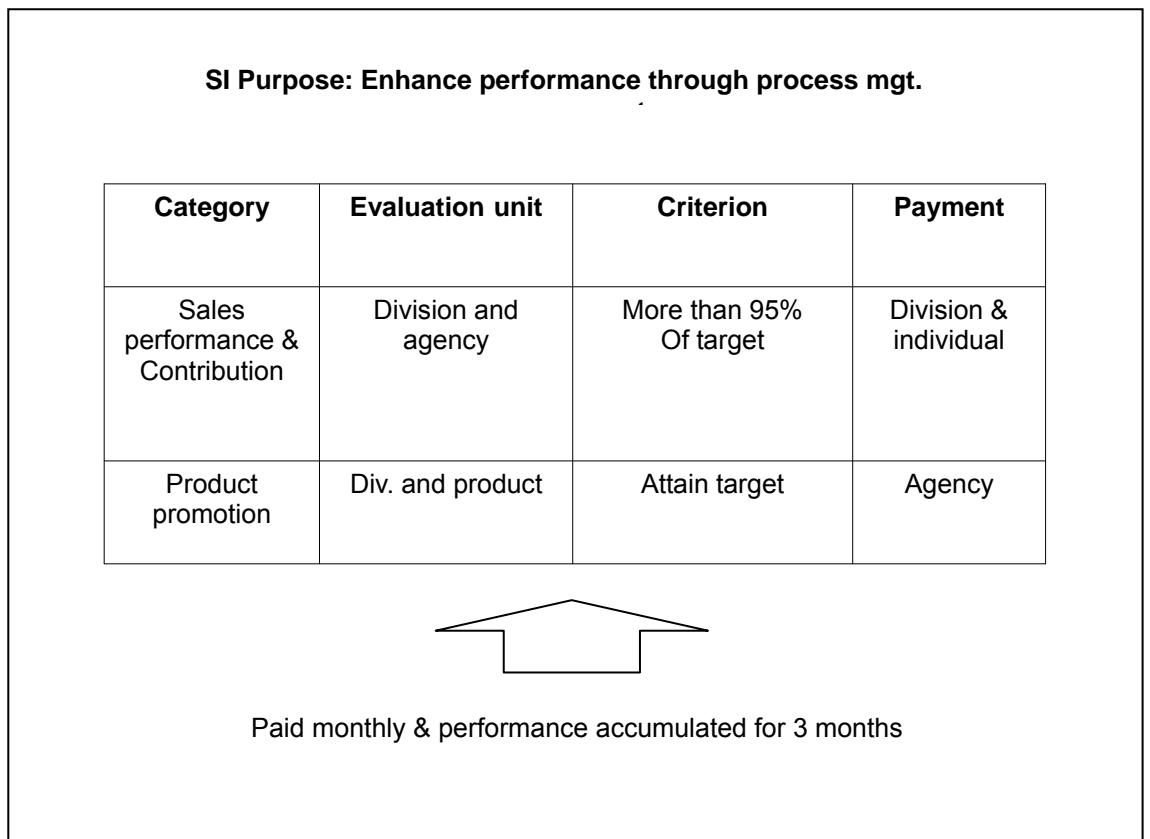
Harim Inc. introduced a performance-linked-payment system to all its employees on 25th December, 2004. The system comprises Sales Incentive (SI), Productivity Incentive (PI) and Profit Share (PS). Among these, SI is a monthly incentive paid to an individual and team that achieves more than 95% of their target after evaluating every sales team in three divisions. PI that is set

up to encourage innovation. It is a quarterly incentive linked to innovation performance and division and business departments are evaluated accordingly. PI also includes distribution of certain specified amount of annual operating profit to its employees.

- **Sales Incentive (SI)**

SI is to enhance performance through process management and the sales department of every division is assessed and paid if the performance target is attained. Evaluation is implemented every month by each division. Monthly assessment is accumulated for three months and incentives are provided in monetary terms, foreign market tour, education etc. SI applies both absolute and relative evaluation and is awarded to good performing employees and teams. SI is also awarded to its affiliated agencies (certified stores, restaurants and catering companies) after evaluating their target management and contribution to the company (Harim Inc.) every month. Particularly, SI for the promotion of new (or existing) product assesses target achievement for the main products. SI procedure is summarized as follows:

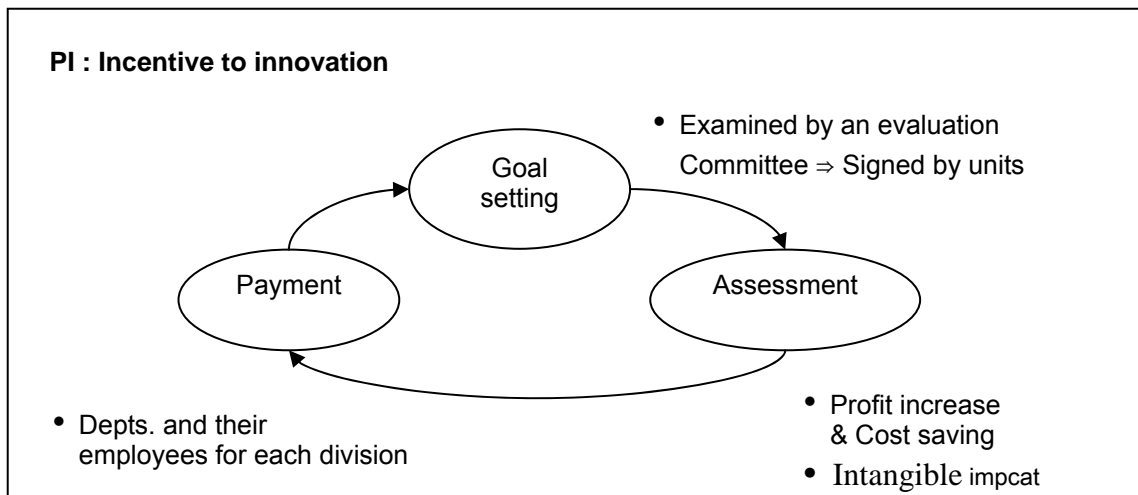
Figure 4.8 Sales Incentive (SI) Procedure of Harim Inc.



- **Productivity Incentive (PI)**

PI is an incentive provided for innovative activities that improve management performance through process innovation. It is paid quarterly to division and business departments but is limited to 50 million Korean Won (approximately 50,000 USD) in maximum. Every year, profit increase and cost savings are used as innovation indices to set the targets, and the incentive is paid to selected departments and its employees after quarterly, bi-annually and yearly evaluation. Target level is set for every department through examination and discussion by the evaluation committee. PI procedure is summarised as follows:

Figure 4.9 Productivity Incentive (PI) Procedure of Harim Inc.



- **Profit Share (PS)**

PS is a distribution of a certain amount of annual profit to employees. A maximum 20% of operating profit is allotted for distribution and is divided according to quarterly contribution of each division. PS is also paid to management employees, production workers, sales persons and part-time employees. Its payment scale is summarised as follows:

Table 4.4 Profit Share (PS) Payment Scale of Harim Inc.

Max. 20% of Operating Profit		More than 20 billion K Won	More than 1.5 billion K Won	More than 1 billion K Won	More than 0.8 billion K Won
Incentive	Administration Employees	200%	150%	120%	100%
	Production	200%	150%	120%	120%
	Sales/Part-time	500,000 Won	400,000 Won	300,000 Won	200,000 Won

Note: One thousand Korean Won is about one USD.

In evaluating PS, weights are given to four evaluation categories to allow for divisional difference (See Table 4.5). However, for over achieving divisional targets a separate compensation scheme will be developed.

Table 4.5 Evaluation Criterion by Division

Criterion	Weight	Division 1 (Farming)	Division 2 (Fresh meat)	Division 3 (Processing)	Headquarter/ Supporting Part
Growth	30%	Output	Sales margin, Sales rev.	Sales weight, Sales rev.	Long and medium term business direction Education/training program
Productivity	30%	Cost saving	Cost/Profit improvement	Cost/Profit improvement	System improvement
Profitability	25%	-Accuracy of expecting mkt demand-supply (supp/demand) -Material depreciation	Operating profit	Operating profit	Total company profit
Stability	15%	non-retrieved Bond, Advance payment	non-retrieved Bond, Inventory asset	non-retrieved Bond, Inventory asset	Bond, Inventory asset

PS grades individual employees by S, A, B, C and D, and pays accordingly. All employees except new employees who had worked less than a year and experienced new employees with less than 6 months on the job are graded. In addition, employees who worked less than 6 months due to education, long-leave and dispatch are exempted from assessment. All exempted are paid the lowest rates among the whole company. Production workers are paid according to the rates prepared by each division. Promotion or other workers employed on daily basis are paid a certain specified amount commensurate with their performance. Table 4.6 summarises the evaluation criterion for employees.

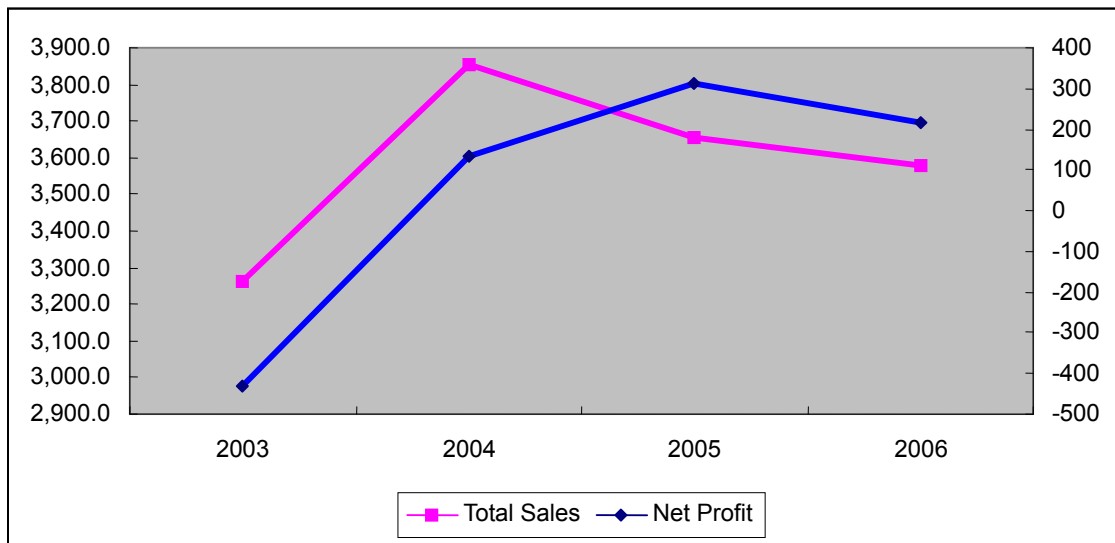
Table 4.6 Employee Evaluation Criterion for Profit Share of Harim Inc.

Grade	S	A	B	C	D
Portion	5%	10%	70%	10%	5%
Range	$\alpha+10\%$	$A+5\%$	α	$\alpha-5\%$	$\alpha-10\%$

4.2.4 The Impact of Evaluation System on Performance

Harim Inc. witnessed a slowdown of its sale since 2003 when it was hit by two continuous disasters, AI outbreak and fire in its processing factory. Total sales of the company increased from 326.3 billion Korean Won in 2003 to 385.3 billion Korean Won in 2004 but decreased to 365.5 billion Korean Won in 2005 and 357.7 billion Korean Won in 2006. The decline of sales since 2004 is, however modest considering the depression in the chicken industry and loss of the production factory (See Figure 4.10). We can see resilience of the company by looking at net profit which increased in 2004 despite a loss due to the fire. It is worth note that Harim Inc. introduced the performance-linked-payment system in the middle of industry depression in 2004 and the system helped to bail out the company from depression.

Figure 4.10 Impact of Evaluation System on Performance in Harim Inc.



4.2.5 What Does a Performance-Linked-Payment System mean to a Local Firm?

Harim Inc. has a production process that integrates farming, processing and marketing and each of these processes is highly outsourced. Much of its chicken farming depends on contracts with farmers by paying them for raising chickens and providing them with chickens and forages. Thus, the quality and quantity of produced chickens can easily be evaluated according to chicken farms. Chicken farms that are run by the company are also subjected to evaluation through well defined standardised product quality. Besides sales incentive the company applies profit sharing and productivity incentives as an incentive system which is rare for a local company in the food industry.

The incentive system was an innovation introduced by a the CEO who was hired for his expertise and career in a major food manufacturing company in Korea. With the introduction of the incentive system in December 2004, Harim Inc. could successfully recover from the depression resulting from AI epidemic and the fire in its processing factory in 2003. Now Harim Inc. is one of the dominant players in the chicken processing industry, sharing 21.9% of the total market and the performance payment system has been influential in introducing innovation.

4.3 Case C: Performance-Linked-Payment System of Maeil Dairy Co. Ltd.

4.3.1 The History, Vision, Mission and Goal

Maeil Ltd. started its business in Gwangju in 1969 and became one of the leading daily products company in Korea after successfully constructing factories throughout the country. The company is an example of a company that was locally brewed and has grown to be Korea's leading total food company through successful expansion. Currently, the company produces cheese, wine, baby clothes, food service as well as milk products, fermented milk, baby food, beverages and soybean milk.

In 2008, the company introduced the new company identity and set up the 5 practical core visions such as: i) Customer Oriented, ii) Initiative and Challenge, iii) Social Contribution, iv) Talent Development, v) Confidence and Trust. It tries to be "the top health food company as the partner of our customer." To ensure continuous growth in the coming days, Maeil Ltd. increased investments in the related fields. The company is working hard to develop fresher milk products by introducing the ESL system and create high value added core business such as baby food products that became the first overseas exports and acquired HACCP. The company also tries to develop new products to meet the various customer needs and explore and foster new businesses to prepare future growth and be the global brand of the total food products company. Table 4.7 summarises the history of Maeil Dairy Co. Ltd.

Table 4.7 Major Milestone of Maeil Dairy Co. Ltd.

Feb 1969	Established Korea Dairy Processing Company
Dec 1973	Completed construction of Gwangju Factory
May 1974	Completed construction of Pyeongtak Factory
Oct 1978	Completed construction of Gyeongsan Factory

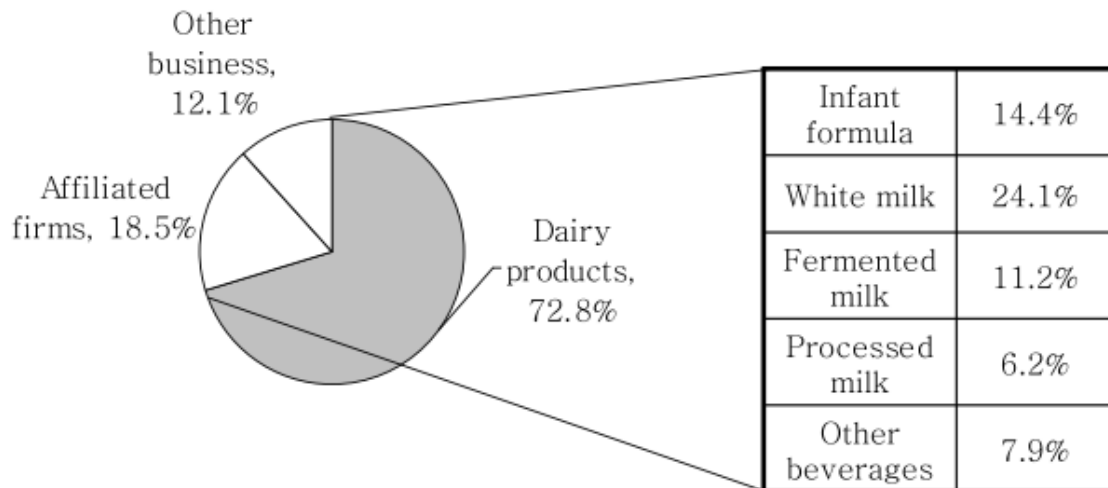
Nov 1989	Established Korea-New Zealand Cheese Corp.
Jul 1997	Established Korea Food Service Co., Ltd (KFSC)
May 1999	Stock listed in the KOSDAQ
Feb 2000	Established IDR International Co., Ltd
Apr 2000	Completed construction of Yeongdong Factory
Oct 2002	Introduced management innovation with ERP system
Feb 2003	Completed construction of Cheongyang Factory
Nov 2004	Completed construction of Gochang Cheese Factory
Feb 2006	Completed construction of Asan Factory
Jan 2007	Declared 2007 Mael Vision

Under the vision “Be the top health food company as the partner of our customers,” Mael Ltd. strives for the continuous growth by expanding to foreign markets, developing a business model that generates profits as well as to strengthen its core capacity as well as being respected by the customers shareholders and partners. The company’s mission is to “Create our customer’s health and happiness through the top quality products,” and its medium term goal is “To be the top 10 food product company till 2012 with 1.6 billion won of the total sales and 1.4 billion won of food products.”

4.3.2 Business Area

Mael Ltd. started its business in dairy products and expanded its business to broad areas in the food industry. Its original business of milk products form about 73% of total sales while the remaining sales comes mostly from other food and health food products produced by affiliated firms. Figure 4.11 depicts Mael’s composition of sales.

Figure 4.11 Sale Composition of Maeil Dairy Co. Ltd.



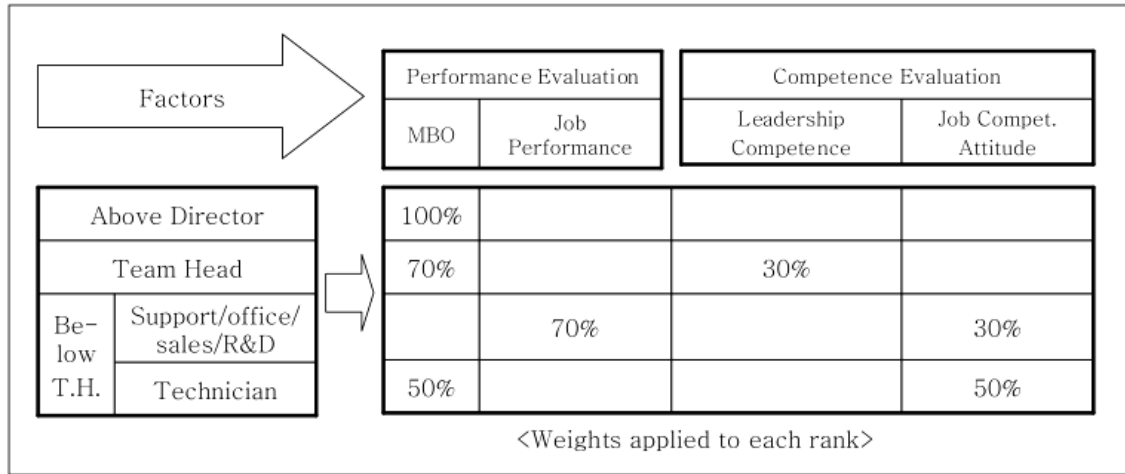
4.3.3 Performance Evaluation System

Maeil Ltd. has a personnel system focusing on employee development and tries to reform the system with an open-mind. In 2007, first year college graduates are paid annual salary of 27 million Korean Won along with 700% of monthly salary as bonus. Employees lower than deputy department manager are paid according to a seniority system in which the monthly salary increases is a pre-determined amount every year along with payment linked to performance. Employees above the rank are paid yearly fixed payments determined through evaluation. Newly hired employees are expected to be promoted to deputy department manager after three years, department manager after four years, deputy section manager after five years and section manager after six years.

- **Weighting System of Evaluation Factors**

Personnel assessment consists of two factors, performance and competence. The categories included in performance evaluation are MBO (Management by Objectives) and job performance, while those related to competence evaluation are leadership and competence/attitude. These factors are weighted differently according to rank. Figure 4.12 depicts the weighting system of evaluation factors of Maeil Dairy Co.

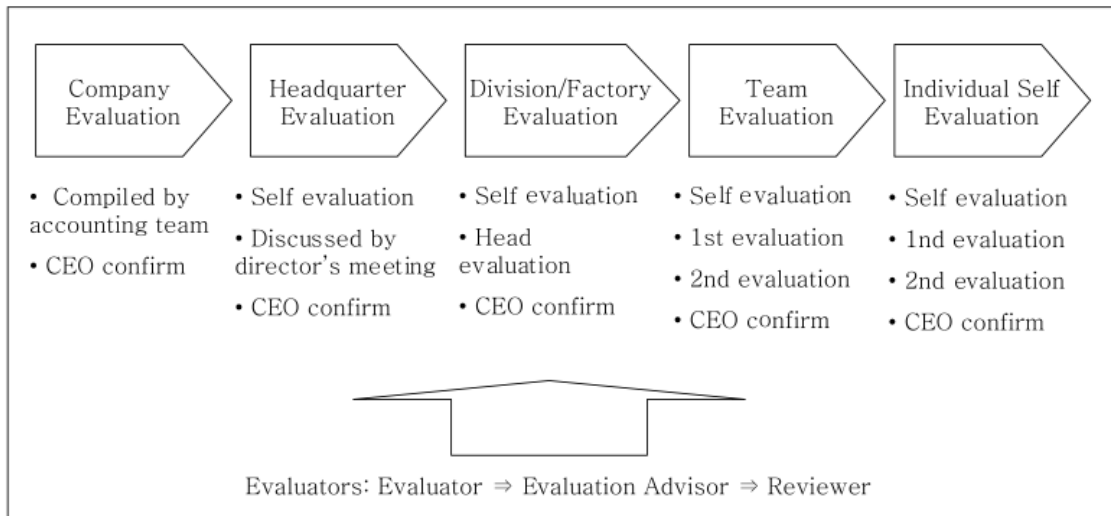
Figure 4.12 Weighting System of Evaluation Factors of Maeil Dairy Co. Ltd.



• **Evaluation Process**

The evaluation process comprises five stages: company evaluation, headquarters evaluation, division/factory evaluation, team evaluation and employee’s self evaluation. Evaluation is compiled by an accounting team for company evaluation and headquarters evaluation goes through employee’s self assessment and directors’ discussion. At division/factory level, evaluation is carried out by head of division/factory and this evaluation is done together with the employee. For team evaluation and individual self evaluation phases, a two stage evaluation processes is implemented. Figure 4.13 shows the evaluation process of Maeil Dairy Co.

Figure 4.13 Evaluation Process of Maeil Dairy Co. Ltd.



For this process, evaluators play a very important role and their job and responsibility are clearly specified. Evaluators include evaluation advisors and reviewers. The evaluator's role is to grade the final evaluation for employees based on performance and competence assessments. Second stage evaluators review first stage evaluation to check the relevancy of evaluation and observance of the rule and can ask for reevaluation if there are any doubts about the evaluation results.

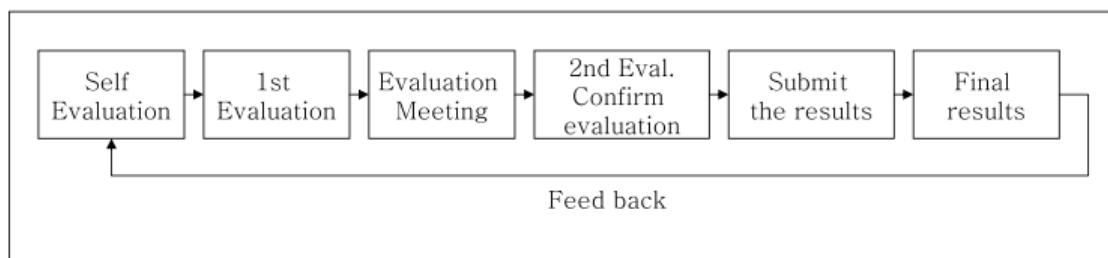
Evaluation advisors operate when team members are too many to handle or employees are out of jurisdiction of evaluators. Evaluation advisors deliver their assessment opinion to evaluators, and are chosen from employees who supervise employees. Finally, reviewers examine overall evaluation to check possible errors to ensure objectivity and could request reevaluation by evaluators if errors are found or adjustment is needed. Reviewers could also ask for change of the results if individual units performance should be balanced with overall evaluation results of their divisions. They can adjust individual employee evaluation and grade distribution. Employees under three months on the job are exempted from the evaluation along with employees who are newly employed, on leave, under contract and temporarily employed.

- **Individual Evaluation Process**

Individual evaluation is the final phase of evaluation process and comprises self evaluation, first evaluation and second evaluation. Main part of self-evaluation is to state his/her job performance and grading, and self-evaluation for competence and attitudes are not implemented. First evaluation measures employees' jobs achievement and grades and their competence/attitude. After evaluation, evaluator discusses the results with employees to derive consensus and provide advice and feedback.

Second evaluation is to confirm the evaluation results. Evaluators review the results and compare them with grades allowed for each division. Evaluation can be returned for further review or confirmed at this stage. Figure 4.14 illustrates individual evaluation process of Maeil Ltd.

Figure 4.14 Individual Evaluation Process of Maeil Dairy Co. Ltd.








4.3.4. Example of Evaluation Implementation

Evaluation is classified into performance and competence, and performance is divided into MBO and job functions. Competence consists of leadership and job competence/attitude. First MBO and leadership competence is examined:

- **Example of MBO (Management by Objective) Evaluation**

MBO evaluation is applied to directors and heads of teams and use absolute grading against target. Figure 4.15 shows an example of MBO evaluation.

**Figure 4.15 Example of MBO Evaluation of Mael Dairy Co. Ltd.
Example of Leadership Competence Evaluation**

①	2007 Strategic Mission	 <p>In early 2007, strategic mission, evaluation index (KPI), weights, Target level are set</p>
②	Evaluation index (KPI)	
③	Weight	
④	Target level	
⑤	2007 Performance	 <p>For each mission, outcome is written</p>
⑥	Attainment rate	 <p>Outcome is compared with target level</p>
⑦	Changed score	 <p>Changed score = weight × attained rate -E.g., if weight is 20% and attained is 95% -CS = 20% × 95% = 19</p>
⑧	Total score	 <p>Total score = sum of changed score</p>

Leadership competence evaluation is applied to head of team and absolute grading is implemented based on leadership competence dictionary. Leadership competence has evaluation categories that include outcome-oriented, leadership and dedication to organisation etc. Evaluators assess and grade the behavior of employees during the evaluation period and competence dictionary is used as measuring standard. Total score is decided depending on the frequency of grade among categories and relative importance of each category. Table 4.8 shows an example of leadership evaluation category of Mael Dairy Co. Ltd.

Table 4.8 Example of Leadership Evaluation Category of Maeil Dairy Co. Ltd.

Category	Competence Definition	Grade				
		D	C	B	A	S
Outcome-oriented	<input type="checkbox"/> Interested enough to work hard and eager enough to challenge to the highest standards. Here, standards include past performance (works to improve), objective measure (results mined), others' performance (competitiveness), and challenge to the goal that nobody has ever reached (innovation).			√		
Leadership	<input type="checkbox"/> Competence revealed in an intention to take a leadership role in a team or other group, and involves a desire to lead others.				√	
Dedication to company	<input type="checkbox"/> Competence or will to behave according to company's objective and priority, act in a way to promote them, and adjust to the need of the organisation.				√	
Total Grade					√	

- **Calculating Final Grade**

For performance and competence evaluation categories, each category's changed score and its weight are used to calculate final changed score (=category changed score × weight), and the summation of these changed scores makes total final score. Evaluation is graded as S/A/B/C/D based on calculated total score according to grading rule. Figure 4.16 shows an example of final grading methods of Maeil Ltd.

**Figure 4.16 Example of Final Grading Methods of Maeil Ltd.
(Applicable to Supporting/Office, Sales, R&D Employees)**

Evaluation Category		Individual Eval. Changed score	Weight	Changed Score	
Performance	MBO				
	Job Performance				
Competence	Job Competence				
	Attitude				
Total Score					
Final Grade					
Evaluator's Opinion					
Grade	S	A	B	C	D
Score	120	110	100	90	80
Result	More th. 110%	100% ~ 110%	90% ~ 100%	80% ~ 90%	Less th. 80%

The final results are now subject to absolute and relative evaluation for review and adjustment. Depending on the results of affiliated division, individual evaluation grade is allocated (based on mixed method of absolute and relative evaluation). Table 4.9 depicts the method:

Table 4.9 Final Review of Evaluation Results of Maeil Ltd.


Div. \ Ind.	D	C	B	A	S
D	Absolute Evaluation			Max. 5%	
C				10%	
B				15%	
A				20%	
S				30%	

4.3.5. Performance-Linked-Payment System

Employees higher than deputy department manager are paid according to fixed annual salary that is partially linked to performance evaluation while employees above the rank are paid yearly fixed payments determined through evaluation. Besides this, the following uniform incentive payment applies to all employees regardless of their rank and work area.

Figure 4.17 Performance-Linked-Payment System of Maeil Ltd.

Performance Incentive Payment (2007)



Target setting	Attainment rate	Amount of payment	Times
All employees	More than 95%	Monthly salary*90%	Once a year
	More than 110%	Monthly salary *120%	Once a year

※ Applies to all employees regardless of position and area

4.3.6. Way of Installing a Performance-Linked-Payment System for a Local Firm

Performance evaluation system has long been utilised by Maeil Ltd but the company uses the evaluation system to determine annual salary of employees. This is the most popular system utilised by Korea's small and medium sized enterprises (SME). Many companies do not think they need other complex profit sharing systems because they often determine employee's annual salary based on performance evaluation (Paik, p. 92). Thus, performance-linked-payment system is narrowly implemented as annual salary payment system that revolves around employee performance. This system is more widely observed than profit-sharing payment system for Korean SMEs.

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