

## **Innovation and Structural Change of the Service Sector in Korea--Focus on the Wholesale and Retail Industry**

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### Abstract

The transition to a knowledge-based economy involves upgrading competitiveness through innovation. That seems obvious in the case of manufacturing, where capacity to adopt new technologies and skills matters more than anything else. With the service sector, however, innovation becomes a blurred area since it involves far broader issues than in manufacturing

Nonetheless, the issue of innovation in the service sector is of particular interest because of the sector's increasing share of employment and output and because it consists mostly of small and medium sized enterprises. If innovative capacity in the service sector can be advanced significantly through knowledge-based activities, then the sector may be able to take on the role of the engine of growth which manufacturing has played for the past century.

Also transformation of small and medium enterprises (SMEs) from backward and traditional entities to modern and robust firms will open a new horizon of economic growth. Hence, before we proceed with analysis of the service sector, we have to first identify the possibility of such innovation. Historical records show that productivity growth of service activities is persistently lower than in manufacturing and even than in agriculture at times. There seems little ground to believe that the trend is to be reversed radically.

Some argue that the recent revolutionary development of information and communication technologies may change this trend but this remains to be seen. If it does happen, then, the transformation of SMEs in the service sector through the ICT revolution will have an immense impact on employment structure and on the competitiveness of the whole economy.

Another issue is the actual path and method of transformation of SMEs. There are two ways the transformation can take place, either traditional SMEs can be transformed into modern firms or modern new firms can emerge while old traditional ones dwindle away.

In order to set policy orientation, it is important to identify the actual way that organization types are transforming and the innovation paths of firms in the service sector.

This paper first examines the general trend of industrial structure in selected countries including Korea and tests the conventional wisdom about the increasing share of services in the process of industrialization.

It will explain the factors driving the expansion of the service sector in terms of employment and output and try to identify the sector's future role in Korea. Then, the analysis focuses in on the wholesale and retail industry. This is because the wholesale and retail industry accounts for the largest share of the service sector both in output and employment and because almost all firms in this industry are SMEs. In recent years the wholesale and retail industry, which has been the most backward and least productive industry, has been undergoing especially volatile changes. The key issue for the development of SMEs in Korea's service sector, especially in the wholesale and retail industry, is to transform traditional firms into modern business operations.

The paper discusses several policy orientations to facilitate this transformation.  
Networking.

The government can foster the development of the service industries by implementing policies to support and accelerate the formation of networks by business associations and firm organizations. Exploiting franchise and chain-networking may be one means for the survival of conventional stores which still serve an important function supplying daily necessities but which are left behind by recent developments. Networking offers them cooperative supply of goods, systematic management of stocks, cost-saving logistics, and managerial support from a large organization.

### Education and training.

Collective and cooperative education and training efforts may help SMEs overcome the organizational and cost burdens of upgrading their business capacity in line with recent developments. Business associations can initiate membership organizations to offer training and education opportunities in marketing skills, customer relationship, inventory management, and chain and franchise formation. In this way the business associations are the essential communication link between the government and firms.

### Indirect policy framework.

Government support for industry should be reoriented towards indirect policies, such as financial and administrative support for the formation of networks, business organizations, and associations, rather than direct incentives such as subsidies, financing, and tax breaks for target areas.

Through an indirect policy framework the government can help build institutional and physical infrastructure, without inhibiting the competitive structure of the market.

An important way for the government to contribute indirect support is providing information service. Communication links with business associations and organizations are essential to disseminate information on new technologies, business prospects, and strategy, education and training.

### Regulation and deregulation.

While deregulation seems to be a core issue for the development of the service industry, the less regulation, the better it is not necessarily true. Many regulations devised in the early stage of industrialization—entry barriers and direct control on price and licensing—should be overhauled to allow wider competition and policies that treat service firms unequally should be scrapped. But there is also a need to strengthen some existing regulations, to introduce new regulations, and to coordinate other regulations that affect the service sector. The government should make concerted efforts to establish clear and transparent trade regulations and to enforce effective market rules in order to counter the effect of traditional non-transparent business practices which distort the relationship between manufacturing suppliers and small stores and hinders the introduction of new information systems. Also strengthening consumers' rights would promote and enlarge the service markets. Revision of regulations that constrain the service industry should take into account other factors in the quality of life such as environmental hazards. Also remodeling the traditional markets should be considered in the context of long-term urban planning involving construction laws and the transport system, among other things.

### Human resource utilization.

The government can support the development of the service industries through programs that promote women's participation in business and help them form organizations and networks. The characteristics of women CEOs coincide with the needs of the service industries. Results of a report on female-managed firms show women managers have a stronger commitment and desire to upgrade their business capacity and to form networks. The qualities and commitment of Korean women constitute an important resource for the economy as a whole, and in particular the development and transition of the service sector may depend on widening the opportunities for women to participate in service businesses.