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# **INSTITUTIONAL ENVIRONMENT IN NORTH KOREA**

**Market structure and overcoming institutional voids**

Master's Thesis  
in International Business

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# 1 INTRODUCTION

## 1.1 Background for the study

The interest to conduct an economic study on North Korea's market potential was sparked by a one-year stay in the South Korean capital, Seoul, where the author studied economics and international relations of Northeast Asia. Having done tasks for the courses on the topic of North Korea, it became evident that political, human rights-oriented and future-scenario-oriented sources were to be found to some extent, however economic research was nearly nonexistent and it was scattered as little pieces here and there. Beginning to familiarize oneself with the topic of North Korea, the author also noticed that the lack and uniformity of previous information had significantly limited the view the author had on North Korea: the image of a totalitarian and isolated state shifted towards a view of a society that remains plagued by several challenges, however with people that take matters into their own hands and are eager to learn and develop the society and economy.

North Korea may be the world's most controversial state. Development of nuclear weapons, poverty, human rights issues and military focus raise well-deserved critique and discussion. Other sources formulate potential scenarios of how and when North Korea would open up and take initiative to reform its structures, or even collapse (Cargill & Parker 2010; Kim & Roland 2012). These urgent issues often overwhelm the media and research, and other news are left with less coverage. Economic research often remains under the news of nuclear tests, provocations, sanctions, speculations and other curiosities. Thus the economic potential is left aside and often a mystic, demonized state or uncertain hopes of reform are pictured. Yet there is more to the story: there are unignorable signs of an emerging middle class, widespread enough to have been named *donju*, the new affluent class of North Korea. Entrepreneurs are running businesses and "doing what the state cannot" in construction, services, real estate and transportation to name just a few sectors (Ah 2015). Due to private actors in the market, private economy has begun to drive a significant "bottom-up" change in the market structures, which is partly facilitated by foreign organizations and individuals conducting business education in local educational institutions (Huhtala 2014; Salmon 2015; Teaching startups in North Korea 2015). Young university students regard themselves as a possible force for an economic shift. They are eagerly participating in various entrepreneurial courses and develop innovative business ideas to solve a variety of problems. (Juujärvi 2015; Huhtala 2014; Karjalainen 2014.) The leadership recognizes a need for improvement of the economy, experimenting with new structures and granting increasing independence to entrepreneurs to manage the businesses (Talmagde 2015; Salmon 2015).

Thus far the majority of foreign investment stems from Chinese investors. Based on an open source center report in 2012, their presence is estimated to account for 75% of foreign investment, followed by Japanese and South Korean investors (Byrne 2016). Some European-based companies have established presence in the market in the form of joint ventures in industries including production, media and communication, pharmaceuticals, construction and gastronomy. However, the European-based joint ventures account for a small minority of foreign investment thus far, and information concerning the ventures remains scarce. There is also presence of aid organizations and socially directed non-profit organizations, the main goal of which is to enhance the development of the country and improve the living standards. These companies have growing potential to turn the existing business and aid into a business that supports the development of market structures. North Korea has abundant, educated and affordable labour force of 12,2 million, making it a large potential market. The country is rich in natural resources and lies between excellent connections to Asia's biggest economic players China, Japan, South Korea and Russia. North Korea has several ports and three major rivers that support ease of transportation in doing business. (Frank 2013, 3; Choe & Huff 2002, 34; Choe, Kim & Cho 2003, 105.) Based on the recent development, North Korea is not only about isolation, nuclear weapons and poverty. It is time for an additional view on the market: total reforms, sudden opening up or collapse scenarios may be replaced by a thought that the rapid spread of down to up marketization is what matters for the future. Its dynamic power is slowly steering the market to change its structures and offer growing business possibilities without any major scenario. Thus it is a market to watch for the future, and should not be simply dismissed as a potential market despite its peculiarity and indisputable challenges.

## **1.2 Research objectives**

During the author's familiarization with North Korea as a research topic, an urgent need was identified for a broader research that realistically studies North Korea's economic potential. A study was needed that would take into account the impediments and difficulties posed by the business environment, and also evaluate the positive facts without being utopian. Thus a gap in literature was identified that needed to be addressed with a study, which focuses on the economic perspective on North Korea, uses recent and variable sources to provide an up-to-date view of the market and provides as realistic a picture of the North Korean market as possible by abandoning the mystification and demonization as well as uncertain, possibly naïve speculations of reform and opening up.

Due to the economic focus of this study, political and international relations issues are left out despite their importance in understanding North Korea. Thus the study addresses

the current market situation of North Korea with a practical and future potential-oriented approach. *The purpose of the study is twofold; first, it aims to provide a holistic view of the current structure of the North Korean market. Second, it aims to provide insights of how to avoid stumbling upon the challenges presented by the missing market structures.* This is done by describing the North Korean market structure, by identifying missing and lacking market-supporting structures in it and by exploring possibilities to overcome the identified voids. Institutional theory is employed as the main theoretical framework for studying the market structure and missing market-supporting structures as well as for operationalizing the terms. *Thus in this study, the market structure is referred to as the institutional environment and missing market-supporting structures are referred to as institutional voids.* Following these objectives, the research question is formulated as follows:

*How can foreign companies overcome institutional voids in the North Korean market?*

The research question is further divided into following sub questions:

1. *What is the institutional environment in North Korea like?*
2. *What are the major institutional voids in the North Korean market?*
3. *What possibilities do foreign companies have to overcome institutional voids?*

The first two sub-questions remain on a market-level. The third sub-question moves towards a firm's strategic level, however the possibilities are derived based on the institutional context of the market and thus firm-specific strategies are left out of the scope. Thus this study can be argued to have a market-oriented perspective. In this study, the term "foreign company" refers to a non-North Korean company. The underlying line of thought is that native companies are intuitively familiar with the structure, institutions and limitations of the market. Thus it was seen as useful to take an outsider's perspective and provide research for any foreign individual or organization interested in the market's potential. This study is largely descriptive by design; however exploratory elements are used in providing insights to the third research sub-question. The study employs qualitative methods of data collection and analysis to be able to describe the current institutional environment and explore alternative possibilities to cope with the institutional voids. Triangulation of methods is used in the collection of data.

In order to answer the research problem, an underlying structure to the study was established. Following figure 1, the study proceeds from describing the existing market structure to describing missing market structures. Finally, possibilities to overcome the missing structures can be presented.

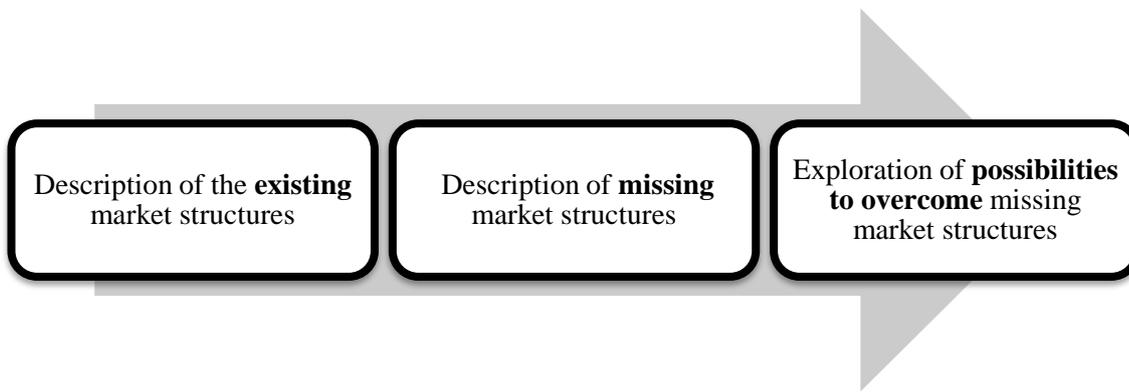


Figure 1 Structure of the study

The structure stems from the sub problems of the research and is used both in the theoretical framework and presentation of findings. Based on the structure, previous literature is used to construct a theoretical framework to provide tools to explore the research problem. Moreover, using the same structure the findings are presented with the help of the theoretical framework. The structure thus enables establishment of a solid structure throughout the study to answer the research problem.

This study contributes to the existing research base at least in the following ways. It broadens the recent English-language economic and market-oriented research base concerning North Korea. Studies concerning the political and human rights -aspects in North Korea exist, and some economy-oriented studies are likely to exist in Korean or Chinese language, however, research base that would describe the North Korean market with a systematical theoretical base and find solutions to the institutional challenges remains thin. Existing research and other material present scenarios of North Korea's reform and opening up to become a modern market-oriented economy, or criticize the country for a variety of reasons, which are justified and highly needed views. However, the author saw a need to contribute to research base that concentrates on the current business possibilities without neither concentrating on the uncertain and possibly naïve hopes about reform and opening up, nor on mere criticism. From a theoretical viewpoint, this study contributes to the existing theoretical base concerning institutional theory by adapting the framework of Khanna, Palepu & Sinha (2005, 11-13; 2010, 45-50) as a tool to map and describe the institutional environment and institutional voids in the North Korean market. The usefulness of the framework as a tool for mapping institutional context is thus tested, even though testing of theories is not the main focus of this study. Moreover, the study contributes to existing research in unifying possibilities to overcome institutional voids over different fields of research under one theme, as unified theories were not available. Thus it aims to aid the process of creating a framework for overcoming institutional voids in emerging, developing and institutionally weak markets in the future, a field that thus far lacks contribution (Khanna & Palepu 2010, 41).

The study is organized as follows. First, a theoretical base is provided in chapters two and three. The main concepts are introduced and discussed and frameworks to study the chosen phenomena are presented. Second, chapter four presents the methodological choices and methods of data collection and analysis in detail to link the research problem to the empirical material. Thus it is described, how the research problem is studied. Moreover, discussion of trustworthiness of the study is presented. Third, the results of the study are presented in chapter five, followed by conclusions in chapter six. Chapter seven lists the used references and appendices provide further information to the data collected for this study.

## **2 INSTITUTIONAL THEORY**

As this study intends to explore the market structure, its context and voids in the North Korean market, institutional theory was chosen as an appropriate framework for the purpose. Institutional theory has been found as a useful tool to explore the underpinning contexts and structure of a market and how they affect firm strategy, performance and success in developing market contexts (Khanna et al. 2005; 4-5; Meyer, Estrin, Bhaumik & Peng 2009, 62; Peng, Wang & Jiang 2008, 922). This chapter aims to explain the concept of institutional theory and the components of the institutional environment, which in this study refers to the market and to the context it is embedded in. Thus it aims to build ground to explore institutional voids by first opening the concept of the environment that the voids are embedded in.

### **2.1 Development of institutional theory**

Institutional theory is concerned with the "set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution" (Davis & North 1971, 6). These ground rules comprise the institutional framework, which provides structure to the daily life and formulates the structure of the market system within which individuals and organizations act (Davis & North 1971, 6; North 1990, 3; Peng 2000, 42). Thus the institutional theory is interested in the relationship between the organization and its environment, and the dynamism of how institutional frameworks and organizations within them interact and evolve over time (Powell & DiMaggio 1991, 12; North 1990, 3; Peng 2002, 253).

The interest in the significance of institutions in international business can be traced back to the early institutionalism in the mid-19th and early 20th century. In the 1970s institutional theory was found as a counterbalancing paradigm to the behavioral revolution, which was criticized by institutional scholars for merely viewing social phenomena as a sum of rational decision-making of individuals and ignoring the influence of the environment and institutional structures on political, economic and social interaction. (North 1990, 4, Powell & DiMaggio 1991, 2; Scott 1995, 14.) Within new institutionalism, two main directions of research may be distinguished, even though closely linked. (Scott 1995, 31). New institutional economics (NIE), represented by e.g. Williamson (1985) and North (1990) focuses on efficiency of exchange in the market and the role of institutions in reducing transaction costs. In NIE the actors are seen as boundedly rational and maximizing their utility, however, in an environment characterized by incentives, constraints and rules of action that arise from the institutional context. (Peng 2002, 252; Gelbuda, Meyer and Delios 2011, 2.) Reducing uncertainty,

lowering transaction costs and facilitating exchange are perceived as the central themes in NIE. Thus North's (1990) approach is often applied in research concerning emerging and developing markets as these markets struggle with providing market structures that would solve problems concerning uncertainty, transaction costs and efficient exchange. (Khanna et al. 2010, 21, Peng 2002, 252.) The sociological school, represented by e.g. Scott (1995) and Powell and DiMaggio (1991), moves away from efficiency, transaction costs and the rational-actor model and emphasizes processes of how and why organizations become isomorphic and seek legitimacy (DiMaggio & Powell 1983, 69; Peng 2000, 252). For a more elaborate discussion on the differing and unifying aspects of the both schools, see e.g. Scott (1995), Powell & DiMaggio (1991) and Gelbuda et al. (2011).

Since the 1990s, institutional theory has emerged as an alternative theoretical lens in business strategy and international business research to provide tools to examine a world that is more international, interconnected and looking towards emerging markets as sources of competitive advantage (Ingram & Silverman 2002, 3-7; Oliver 1997, 697-698). Traditionally, two theoretical frameworks have been employed to study firms' performance and success from somewhat different perspectives. The industry-based view, largely developed by Porter (1980) argues that the industry-level factors determine to a great extent the strategy and success or failure of a firm. On the other hand, the resource-based view represented by Barney (1991) argues that firm-specific capabilities largely define the strategy and the success or failure of a firm. (Oliver 1997, 697-698.) These two theories can be seen as complementary, however, they can be criticized for leaving out of the picture what formulates the context of competition between firms and industries: the formal and informal institutions that the market consists of (Peng et al. 2008, 920). Institutional theory scholars argue that in addition to considering the industry-specific factors that shape the competition within a given market and the firm-specific resources and capabilities that firms use to generate competitive advantage, it is useful to pay attention to the institutional framework within a given market (Powell & DiMaggio 1991, 2; Peng 2000, 41-42; Peng et al. 2008, 920).

Both the industry-based view and the resource-based view have largely been developed in the Western countries as a response to trying to understand the competition between firms and factors that influence firm strategy and performance in developed economies. Institutional framework has been long assumed as a background condition, as often in developed economies, institutions are stable and developed and therefore fulfill their market-enabling and supporting role. Thus they have been seen as needless to be addressed explicitly. (Peng et al. 2008, 922; Peng 2003, 275.) However, recently the influences of institutions, e.g. laws and regulations, societal norms and rules on the efficient functioning of a market and on firm strategy and performance have been recognized as significant to a great extent (Peng et al. 2008, 920; Peng 2000 41-42; Powell & DiMaggio 1991, 28). Especially in emerging and developing markets, the role of

institutions as market-supporting and -enabling structures becomes apparent, when firms face a varying degree of absence or underdevelopment of several market-supporting institutions and struggle to overcome them (Peng et al. 2008, 922). With the interest shifting to exploring business opportunities in emerging markets, research has found that especially in emerging and developing markets, the institutional environment that the market is part of and consists of, has great significance in influencing firms' strategies, performance and success (Meyer et al. 2009, 62; Khanna et al. 2005; 4-5; Khanna & Palepu 1997; 41; Peng et al. 2008, 921). Moreover, research has recognized that there are profound differences in the institutional frameworks between developed and emerging countries, as well as between emerging and developing economies (Chacar & Vissa 2005, 934; Peng et al. 2008, 923; Hafsi & Farashahi 2005, 500). Therefore, it has become evident that the same mechanisms that explain firms' strategic choices and performance in developed economies may not function in emerging markets. Thus institution-based view has been found a useful tool to explore the market structure of emerging, transition and developing economies, the underpinning contexts of the market and how they affect firm strategy, performance and success. (Peng 2008, 922.)

For the purpose of this study, the NIE approach and North's (1990) theory of institutions is applied for the following reasons. First, the focus lies on the market-level and it thus fits a market-oriented study as it allows to examine, how the market and its context are constructed, interlinked and how the institutions (or lack of them) may affect firms. The sociological school is interested more in organizations and their responses to institutions and thus organizations are seen as the starting point, not the market itself (DiMaggio & Powell 1983, 69; Peng 2000, 252). Moreover, North's (1990) theoretical ground addresses themes that are central in emerging and developing markets: increased transaction costs, reducing uncertainty and struggling efficiency (North 1995, 17-19). Therefore, the theoretical approach is applied as a base for a wide variety of research concerning institutional voids (see e.g. Khanna et al. 2010; Khanna et al. 2005; Khanna & Palepu 1997; Schrammel, 2012). For these reasons it was identified as a suitable approach for the market -level and institutional voids -focused purpose of this study.

## **2.2 The concepts of institutions, market and its context**

Institutions can be explained as "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" (North 1990, 3). Scott (1995, 33) further explains institutions as "regulative, normative and cognitive structures and activities that provide stability and meaning to social behavior". Institutions simultaneously constrain and enable the actors in the markets: on one hand, institutional framework sets limits to the set of choices within the given institutional context (North

1990, 4; Tracey & Phillips 2011, 27). For example laws, established business practices and required product standards create expectations of preferred action that set constraints to which firms should comply in order to assure survival in the markets. On the other hand, institutions define the accepted and encouraged behavior of organizations and thus provide tools for understanding the actions of others as procedures become more expected and understandable. (Peng 2002, 252; Tracey & Phillips 2011, 27.)

The role of institutions is to provide context and structure to the markets, thus supporting the market by setting rules of actions, acting as intermediaries in transactions, providing information and reducing uncertainty (North 1990, 3, 5,6; Scott 1995, 33; Khanna & Palepu 1997, 41). Moreover, institutions affect firms' available, encouraged and prohibited choices of action as "institutions directly determine what arrows a firm has in its quiver as it struggles to formulate and implement strategy, and to create competitive advantage" (Ingram & Silverman 2002, 20). Thus institutions have their role on several levels: they provide context for the markets, formulate the structure of the market and guide preferred actions and strategies of organizations and individuals in the market. The market, its context and actors in the market are interconnected, as the different levels are both constrained by institutions and produce institutions. (Ingram & Silverman 2002, 7-8.)

Especially in institutionally underdeveloped markets, reducing uncertainty is crucial as high uncertainty is associated with higher risk which may lead to higher costs of transaction or even failure in economic exchange (North 1990, 33). In uncertain institutional framework the costs of transaction tend to be higher due to two reasons. First, costs of information and measuring the quality of the product or service in question may prove to be higher as information asymmetries -the differing degree of knowledge about the product between the buyer and the seller- prevail (Khanna & Palepu 2010, 19). Moreover, obtaining reliable business information may be costly as substantial resources need to be devoted. Second, if the institutional framework is weak, enforcement mechanisms may be expected to be weak as well. Thus it might be unsure, whether violations are punished accordingly and fairly, which increases the risk of opportunistic behaviour. Thus transactions often include a risk premium to cover for the uncertainty of a successful transaction. (North 1990, 6, 27-29, 30-33, 41, 57-58.) For example, a firm may have to rely on informal networks in enforcing contracts if the formal regulatory institutions lack enforcement power (Puffer, McCarthy & Boisot 2009, 441). Finding partners, building and nurturing informal networks may include significant costs that may not take place in economies where the institutional environment is stable and developed. Thus institutions decrease the risk of doing business as the actions of others become predictable, information asymmetries decrease and enforcement mechanisms exist. This reduces the costs of transaction as firms do not need to prepare for complexities and surprises in their transactions. (Peng 2000, 42-43; Tracey & Phillips 2011, 27.)

In this study the institutional view of the market is adopted: markets are defined as spaces for social and economic interaction, consisting of complex and intertwined structures of institutions. Markets are seen as interactions between culture, politics, social constructions as organizations and individuals. Research argues that markets are more constructed spaces than occurring naturally and largely embedded in their contexts rather than separate entities from their local context. (Mair, Marti & Ventresca 2012, 820-821; North 1990, 34, 69.) Institutional theory has proven to be insightful as a perspective in explaining the structure of markets that are still in their early phase of development and undergoing pervasive institutional changes. (Hoskisson, Lorainne, Lau & Wright 2000, 252; Ahlstrom & Bruton 2006, 299; Bruton, Ahlstrom & Li 2010, 422.) Moreover, exploring the institutional context the market, e.g. the state, political and judicial system may help in understanding the formal and informal structures that the market is embedded in, as it is intertwined with its context. The spectrum and the degree of development of institutions vary widely across different emerging markets and also within the market. Thus scholars argue that it is important to grasp that there is not a specific type of institution or institutional structure that automatically leads to a well-functioning, efficient market. (Mair et al. 2012, 820; Khanna & Palepu. 2010, 27.) However, according to Khanna and Palepu (2010, 27), institutional approach may help to identify potential factors that inhibit a market from functioning efficiently. Mapping the institutional environment of a market and voids embedded in it may help a firm to identify challenges in the market and find ways to avoid stumbling upon them. Moreover, it may further help to locate unexpected business opportunities. (Khanna & Palepu. 2010, 40, 44.) Companies that come to a thorough understanding of the complex, intertwined system of institutions, markets and their contexts in a chosen market can generate a competitive advantage by understanding the market-specific challenges and finding ways to avoid them. Moreover, a firm that is familiar with the institutional environment of the target market is more likely to discover business opportunities for the specific market.

### **2.3 Institutional environment**

In this study, the institutional environment refers to the market and its context. Thus the presented research concerning institutional environment aims to provide tools to explain, how the context of a market and the market itself are structured and moreover, how they are interlinked.

Institutional framework plays a significant role in setting the structure of the market, ensuring well-functioning markets and viable exchange. According to North (1990), the institutional environment that makes up both the market and its context, consists of informal and formal institutions (North 1990, 4, 36; Peng et al. 2008, 922). Within the

sociological tradition of the new institutional theory, Scott (1995) sees that the institutional environment consists of three pillars: regulative, normative and cognitive. The regulative pillar corresponds with the formal institutions to some extent. The normative and cognitive dimensions are seen as socially constructed and they can be perceived as corresponding to the informal institutional environment of North's (1990) categorization (Estrin, Baghdasaryan & Meyer 2009, 1189; Peng & Heath 1996, 499; Ferreira, Li & Jang 2007, 14). Formal institutions can be defined as rules that are determined by written documents and thus are often found in explicit forms. Constitutions, judicial and economic rules, property rights and contracts are examples of formal institutions. These rules may directly affect e.g. the range of possible entry strategies to a certain market in the form of rules concerning foreign investment and ownership. (Meyer et al. 2009, 63.) The function of the formal institutions is to facilitate exchange in the market by providing stable structures for exchange, thus creating a framework within which firms and individuals can interact without excess uncertainty, risks and transaction costs (North 1990, 47; Meyer et al. 2009, 63). Informal institutions are defined as socially accepted guidelines that are transmitted via culture and social heritage. They are often based on tacit understanding and thus most often are not found in any explicit form. (North 1990, 4, 36-37, 46-47; Zenger, Lazzarini & Poppo 2002, 278.) Informal institutions include e.g. culture, conventions, norms of behavior and traditions. Informal institutions arise from coordination problems and exist as social conventions that are in common interest to comply with in order to provide stability and thus reduce transaction costs in the market. (North 1990, 4; Zenger et al. 2002, 281.)

Formal institutions may reinforce, replace or modify informal institutions and increase their effectiveness (North 1990, 47; Zenger, Lazzarini & Poppo 2002, 278). However, Puffer et al. (2009, 441) and Peng and Heath (1996) argue in their studies that when doing business in markets characterized by weak or lacking formal institutions, firms move to exploit informal institutions, like networks of trust in ensuring successful exchange. The tendency to emphasize networks, trust and kinship ties is certainly related to cultural factors: collectivist and Confucian countries are the most common examples of relationship-based business cultures (Peng & Heath 1996, 505). However, evidence of reliance on informal institutions to provide stability and enforcement power during transition periods has been found in e.g. Central and Eastern European countries and Russia as well (Peng 2002, 260; Peng & Heath 1996, 505). The economies in Asia differ from each other significantly in several respects; however, many of the markets fail to a varying degree to provide a credible, property-rights based legal system, a stable political environment and functioning markets, such as the capital market, to provide access to strategic resources (Peng & Heath 1996, 503, 506; Khanna & Palepu 1997, 44; Peng 2002, 257). Thus a lacking formal institutional environment may increase the propensity

of relying on informal institutions in addition to the cultural tendency to emphasize networks in doing business.

Drawing from Khanna and Palepu's (2010) and Khanna et al.'s (2005; 1997, 43) research of institutional voids in emerging markets, the institutional environment can be categorized into the macro context and economic system. In this study, the macro context refers to the context of a market and the economic system refers to the market itself. The components are illustrated in figure 2.

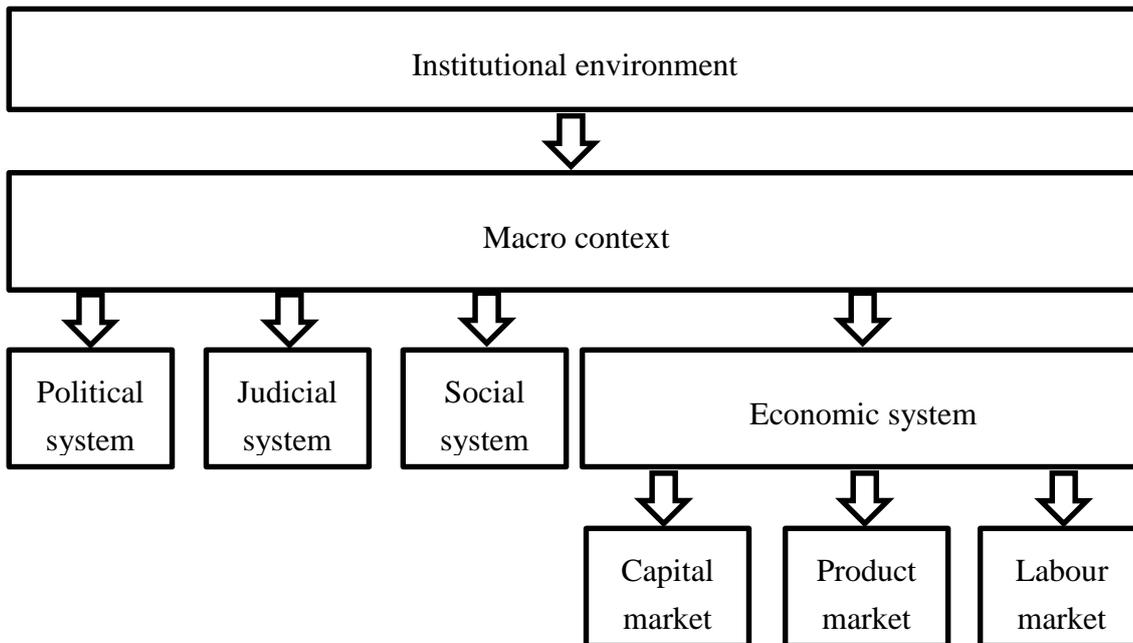


Figure 2 Components of the institutional environment (based on Khanna et al. 2005)

The macro context includes political, judicial and social systems of the economy, and is comparable with North's (1990) categorization of formal and informal institutions. The macro context sets the framework for the market and has thus an important role in setting structures that support the efficient functioning of the whole market. The political system affects the market by e.g. providing institutions that regulate the market reliably, transparently and openly, thus enabling systems for financial reporting, auditing and market research to develop. The political system may also affect the market's openness to attract foreign investment. The judicial system e.g. provides structure to ensure the enforcement of contracts, thus reducing uncertainty and transaction costs related to possibility of opportunism. Moreover, it provides regulations to the economic system and acts as a mechanism to settle disputes. The social system determines e.g. the importance of kinship ties and relationships in business as well as the overall trustworthiness of honouring contracts and toleration of corruption. (Khanna & Palepu 2010, 34-35, 48-49.) Khanna

and Palepu's (2010, 45-50) categorization provides a tool to explore the institutional structures that affect and interact with the market and that the market is intertwined with.

The economic system is sub-categorized into capital, product and labour markets (figure 2). The categorization of the market (the economic system) into three subcategories provides a tool to look into the market's institutional structures on a more detailed and structured level and is thus employed both when studying the market and institutional voids. On the market level however, the informal institutions are left out of the scope, as they are seen to interact with the market on the context-level. Examples of capital market institutions that lower uncertainty and transaction costs are e.g. intermediaries providing financial services such as banking, insurance and venture capital. These institutions help the flow of capital in the market and provide efficient access to capital for different actors in the market. Accounting standards and auditing regulations decrease uncertainty by providing credible framework for financial information. (Khanna & Palepu 2010, 23.) The product market institutions provide structures that ensure reliable and efficient disclosure of information concerning customer preferences, products and services. Moreover, they ensure networks of manufacturers, retailers and supply chains to function efficiently (Khanna & Palepu 2010, 22). Labour market institutions, e.g. educational institutions, employment agencies, head hunters, employment laws and contracts act as institutions that provide for knowledge and skills, act as intermediaries bringing potential employees' and employers' needs together and protect the interests of both employees and employers (Khanna et al. 2010, 24).

## **2.4 Framework for studying institutional environment**

In this chapter the core concepts of institutional theory have been presented. North's (1990) new institutional economics -based approach is employed for this study, as it is commonly used as a base for research on institutional voids in emerging markets. Moreover, it focuses more on reducing uncertainty, transaction costs and facilitating of exchange that are perceived as crucial themes when studying markets and firm strategies in emerging and developing economies. (Khanna & Palepu 2010, 17-20; Khanna et al. 2005, 10, 13; Mair, Marti & Ganly 2007, 36; Mair et al. 2012, 821; Hoskisson et al. 2000, 252; Meyer et al. 2009, 62.) Institutions are seen to support the market and create structures that lower uncertainty and transaction costs for actors in the market. In turn, the market and its context consist of interlinked structures of institutions that altogether make up the institutional environment to facilitate transactions in the market. (North 1990, 3, 5,6; Scott 1995, 33; Khanna & Palepu 1997, 41; Mair et al. 2012, 820-821.)

When studying the institutional environment in this study, North's (1990) categorization of formal and informal institutions is employed as a base. The

categorization allows to look into the formal institutional structures of the *market's context* as well as include the informal institutions of the market's context that affect the market. However, for the purpose of studying the *market-level* institutions, the informal institutions are left out of the scope. They are seen to affect the market from the context-level and are thus included only in the market's contextual level. Moreover, informal institutions cannot contain institutional voids, as they are constructed less intentionally and evolve over time without conscious construction (Zenger et al. 2002, 184). Thus only formal institutional structures of the market are taken into account in order to spot institutional voids in the next phase.

The framework developed by Khanna et al. (2005) and Khanna & Palepu (2010) for spotting institutional voids is adapted for studying the institutional environment of North Korea in this study. The framework follows the components of the institutional environment presented in figure 2. Following figure 2, *the context of a market* is referred to as the macro context, and it is divided into political, judicial and social systems. The political and judicial systems represent the formal institutions and the social system represents the informal institutions of the market's context. Media was added as a category based on the framework from Khanna et al. (2005, 11-13). *The market level* is referred to as the economic system, which is divided into capital, product and labour markets, all representing formal institutional structures of a market. The framework will be completed with empirical material arising from content analysis and expert interviews, which will be elaborated in more detail in chapter 4 as the methodological choices are discussed. Moreover, it serves as a base to develop the classification system to analyse the data in this study.

Khanna and Palepu's (2010; 2005) framework was chosen as it was seen as a developed and practical tool for mapping several levels and aspects of the institutional environment in an accurate and structured manner. Khanna and Palepu's (2010) framework allows to further define both the context of the market and the market itself. Thus the political, judicial and social aspects of the market's context - which are argued to significantly affect the economic system especially in developing and uncertain markets - can be studied in a more structured way. Moreover, the categorization of the economic system into three sub-categories allows to explore the different institutional structures of the economic system more accurately and in a defined way. The categorizations thus follow the definition of a market as an interconnected system with its context. (Mair et al. 2012, 820-821; North 1990, 34, 69). Although the framework originally directs towards spotting institutional voids, it was seen as logical to employ the framework in mapping the institutional environment as a whole. The same framework is applied in mapping institutional voids and thus the structuration of the institutional environment and institutional voids remain easily comparable.

### **3 OVERCOMING INSTITUTIONAL VOIDS**

In this study it was established that markets and their context consist of complex and intertwined structures of institutions (Mair et al. 2012, 820-821; North 1990, 34, 69). However institutional structures vary across economies and particularly in emerging and developing economies, where the institutional structure of the market is still developing to varying extent, lacking institutions may present challenges for firms seeking to operate in the market. This chapter aims to discuss the concept of institutional voids and present a framework for mapping institutional voids in a given market. Moreover, it aims to introduce alternatives arising from theoretical literature, how companies may overcome the challenges caused by institutional voids.

#### **3.1 Institutional voids**

According to Khanna & Palepu (2010, 14) a major feature that distinguishes developed markets from emerging and developing markets is how easily sellers and buyers can come together to conduct business. Specialized intermediaries, such as financial analysts, brokering services, auditors and adjudicators are market institutions that facilitate exchange and lower transaction costs. However, in most emerging and developing markets, firms face a varying degree of absence or underdevelopment of several market-supporting institutions. Thus Khanna et al. (2005, 3; 2010, 21, 29) argue that in order to find a suitable strategy to overcome institutional voids, a thorough familiarization to the market's institutional context should be the first step, followed by systematical mapping of key institutional voids in the target market. In addition to influencing the costs of transaction, institutional voids are a major source of challenges when operating in institutionally weak market. However, institutional voids may also represent opportunities for institutional entrepreneurs (Tracey & Phillips 2011, 29; Mair et al. 2012, 843; Mair et al. 2007, 37).

North (1990) explains institutional voids as “insufficient institutions” that fail to accomplish their market-supporting role. Khanna et al. (2005, 4) explain institutional voids as “absence of specialized intermediaries, regulatory systems and contract-enforcing mechanisms”, implying that voids can occur both on the market and context level. Ricard, Enright, Ghemawat, Hart and Khanna (2004, 184) define institutional voids on a market level as missing intermediaries that act between potential buyers and sellers by bringing them together and thus reducing costs of transaction. In this study, institutional voids are explained as missing or failing institutions in the institutional environment that would support the market and business operations both on the market's contextual and on the market level. (Khanna & Palepu 1997, 41; Khanna et al. 2005, 4; Mair et al. 2007, 35-36).

Khanna and Palepu (2010, 16; 2005, 11-13) argue that institutional voids can be identified within the product, labour and capital markets as well as within the macro context of the market, referring to the government and other political actors, judicial system, media and overall attitudes towards foreign investment. Institutional voids in the product markets affect costs of transaction as intermediaries are missing to provide information about e.g. possible business partners, customer preferences and customer segments. Voids in the capital markets may increase difficulties in raising capital, directing investments and ensuring auditing standards. Moreover, finding talented managers and employees may prove cumbersome and time-consuming, if there are no service providers in the labour market. Within the macro context, the political stability as well as government's attitude towards foreign investors influence the ease of doing business in the host country. Moreover, government intervention and regulation affects a firm's spectrum of possible business strategies as home strategies may be difficult to execute in the host country. (Khanna & Palepu 2010, 16; Khanna et al. 2005, 11-13.)

In emerging and developing countries, institutional voids are often a result of too fast changes in the institutional environment, rather than lack of changes (Hoskisson et al. 2000, 252). The rapid changes result in traditional practices to be overridden and replaced with new, however often unfinished structures that have not had sufficient time to be institutionalized. They may conflict with the traditional structures and customs as well as with other newly introduced bits and pieces of institutions. Thus the competing and overlapping institutions cannot formulate a stable and credible framework to support business operations, but create uncertainty about appropriate and supported practices as the "rules of the game" are not clear. (Farashahi & Hafsi 2009, 645; North 1990, 3.) Moreover, old institutions may be losing their power and stability while new institutions in the political, judicial and economic environment have been developed rapidly and remain unfinished, leading to actual voids in the institutional environment (Khanna & Palepu 2000, 269-270). Institutional voids and instability of the institutional environment create disorientation for firms' strategic choices, as no institutional logic guides preferred action of firms, previous experiences may prove unhelpful for making future strategic decisions, and cause-effect relationships in the economic system remain unclear due to rapid changes. Thus firms need to cope with the challenges and come up with ways to overcome the challenges and/or influence the institutional framework to fill the voids.

As explained, the market's context is seen to include both formal institutions (political and judicial institutional structures) and informal institutions (social system) (Khanna & Palepu 2010, 21-24, 30-37, 45-50; 2005, 7-8, 11-13; 1997, 43). However, formal institutions are seen as constructed on purpose, whereas informal institutions such as culture, customs and traditions have a more continuous nature that develops gradually without intention. Thus informal institutions cannot have voids as such. (Zenger et al.

2002, 283.) Therefore, when studying institutional voids, the informal institutions are left out of the scope.

### **3.2 Possibilities to overcome institutional voids in institutionally weak markets**

The institutional environment of immature markets is likely to pose varying challenges, yet also offering opportunities for firms seeking broader scope of markets, growth opportunities or access to crucial resources or capabilities in a certain industry (Cavusgil, Ghauri & Akcal 2013, 205). In addition to firm-specific resources and industry-related factors the broader institutional environment of the host country sets constraints and incentives within which firms have to act in order to ensure survival and smooth business transactions in the market (Peng 2002, 251; Peng et al. 2008, 920; Farashahi & Hafsi 2009, 643). Thus the challenges, constraints and incentives from the formal and informal institutional environment have a bearing on the firm performance in an institutionally weak market. Moreover, firms may respond to institutional challenges and thus try to tackle them. (Henisz 2004, 5). This chapter will present alternatives arising from literature that may be considered in overcoming the voids in institutionally weak markets.

#### **3.2.1 *Gaining legitimacy***

In institutional theory, it is presented that firms conform to formal rules and informal customs of the institutional environment in order to gain legitimacy in the host country, which may enhance the organizations' chances of survival by granting access to several resources and increase stability through overall acceptance in the host country (Meyer & Rowan 1977, 340; Farashahi & Hafsi 2009, 643; Gelbuda et al. 2008, 4; Tan & Litschert, 1994). Moreover, conforming to accepted set of strategies to enter the country may be a prerequisite for successful entry, or entry at all. Thus this study follows Suchman's (1995, 574) definition of legitimacy as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions". Tan and Litschert (1994, 3) argue in their study that in countries, where the state exercises strong power over the economy and businesses, firms often conform to the rules and regulations of the dominant power in order to gain legitimacy and thus enhance survival prospects. Farashahi and Hafsi (2009, 643) have studied firm performance in Iran and argue that gaining legitimacy serves as one of the most important tools to ensure survival when doing business in and institutionally instable environment. Gaining legitimacy may increase possibilities of gaining stronger social-

psychological acceptance from the external environment and thus further enhancing access to needed resources (Gelbuda et al. 2008, 4). Thus from the point of view of doing business in an institutionally weak environment, gaining and maintaining legitimacy can be seen as a prerequisite for successful operations in the host country.

### 3.2.2 *Networks as strategies*

The network-based strategy refers to a firm strategy holding networks with different actors as key pieces of the firm strategy (Peng & Heath 1996). Peng and Luo (2000, 486) argue that in a market characterized by weak institutional support for business and great institutional uncertainty, firms tend to rely more on networks and relationships when starting and conducting business (Peng & Luo 2000, 486; Puffer et al. 2010, 441). Moreover, managerial networks in various transition economies including the former Soviet republics and China may contain valuable social capital that can compensate for the institutional voids, defined as failing or missing market-supporting institutions in this study. Governments may play a crucial role in the economic environment of emerging and developing markets, which highlights the importance of building networks with the governmental sector as well. (Khanna & Palepu 1997; Brouthers & Bamossy 1997, 287.) Nee (1992) and Walder (1995) have found that new firms that are building relationships with governmental actors show better performance, and Luo and Chen (1997, 15) show in their study that relationships with other firms' managers result in positive effects for firm performance.

In a market that relies heavily on informal networks, gaining access to those networks may become a critical asset in doing business successfully. E.g. *guanxi* in China and *blat* in Russia refer to cultivating personal relationships with e.g. managers of other firms and governmental authorities. These relationships play a significant role in the business culture of both countries, facilitating or impeding successful business transactions and therefore significantly affecting firm performance. (Meyer & Nguyen 2005, 75; Peng & Heath 1996, 505.) Meyer et al. (2009, 65) and Peng and Heath (1996) argue that in a market that lacks effective legal enforcement of e.g. property rights and framework for contract enforcement, relying on network-based strategies may enhance the firms' possibilities to enforce contracts with the help of trust, which is often a crucial part of informal relationships with various partners in business. However, Peng & Luo (2000, 486) add that while relationships with government officials, other managers and supply chain actors are a key factor in institutionally weak markets, they are not the only factors guaranteeing good firm performance. Also more traditional factors such as a fitting strategy, quality of the goods and firm effectiveness affect the firm's success. However,

developing network-based strategies is of great significance when operating in institutionally weak markets as the often substitute for formal legal framework, however, also require time and investment to develop, thus incurring costs and risks.

### **3.2.3 Partnerships with local companies**

The host country's institutional framework largely affects the permissible entry strategies, costs of doing business and ability to access to needed resources in the market. Lacking formal institutional rules are often compensated by informal networks between firms and government officials, highlighting the importance of network-based strategies as a tool to access the local informal networks, which often make or break business transactions (Peng & Heath 1996, 500). Studies have shown that firms tend to choose strategies involving low commitment instead of committing substantial equity and resources when entering markets that are characterized by lacking or failing institutional framework (Ferreira et al. 2007, 14; Xu & Shenkar 2002, 614; Xu, Pan & Beamish 2004, 289, 296). Moreover, Meyer and Nguyen (2005, 75) argue in their study that the weaker the institutional framework, the more likely a foreign firm is to enter in a joint venture in order to gain access to critical informal networks. Meyer et al. (2009, 64) continue that formal rules may set the permissible range of equity, thus often prohibiting greenfield investments and/or acquisitions in developing and emerging economies that are protective towards local firms. Moreover, acquisitions and greenfield investments often prove costly and uncertain in the absence of reliable legal and financial markets, inefficient contract enforcement and lack of information about local firms.

The host country firms with local networks may hold access to critical resources, such as certain markets, licenses, permissions and relationships (Meyer & Nguyen 2005, 67; Hoskisson et al. 2000, 256; Brouters & Bamossy 1997, 287). Thus a partnership with a local firm may be a viable way to learn about the business environment and gain access to networks and resources that often bridge the gaps of missing formal institutional structures. Moreover, if the local market for needed resources is underdeveloped and institutions facilitating transactions are missing, buying the needed resources via market transaction may become cumbersome, costly and uncertain (Meyer et al. 2009, 63). Thus a joint venture with a local partner helps in decreasing costs of transaction, as resources may be accessed with the help of the local partner, compared to searching for and evaluating information, accessing resources and finding business partners in an institutionally incomplete market (Meyer et al. 2009, 64). Information asymmetries are a common challenge in institutionally weak markets, arising from lack of intermediaries that would gather, evaluate and share reliable information in the market. As local companies are prone to holding more information compared to foreign entrants, engaging

with local partner may serve as a tool to access valuable information and thus decrease costs of doing business. (Meyer 2001, 360; Meyer et al. 2009, 63.) Joint ventures and other forms of partnerships also allow the companies to limit the amount of committed equity and resources, thus sharing the risks between the partners. Joint ventures and partnerships naturally present challenges in managing the business and finding a suitable partner in an institutionally weak market may take time, bind resources and require a few trial periods. However, joint ventures may be an effective way to access crucial networks, thus opening access to several resources, decrease transaction costs and allow companies to share the risks related to business in a market with weak institutional framework.

### **3.2.4 Partnerships with business groups and conglomerates**

In underdeveloped markets the business environment is argued to be dominated by business groups, the state or by dominant stakeholders, such as families to a varying degree (Meyer et al. 2009, 64; Khanna & Palepu 2000, 268; Khanna & Palepu 2001, 45). Khanna and Palepu (2001, 45-47) characterize business groups as organizational “responses to market failures that arise in the particular institutional contexts of emerging economies”. As institutional voids are seen as market failures and missing structures raising transaction costs, it is argued that business groups may help individual firms perform better by offering structures that cover for lacking or failing institutions in the capital, labour and product markets. E.g. *grupos* in South America, *chaebols* in South Korea and business houses in India are examples of business groups that are characterized by highly extensive networks between managers within and across firms, government officials, employees and external suppliers etc. (Khanna & Palepu 2001, 46.) Moreover, despite different economic and institutional contexts, the business groups often control a large share of a country’s economic power, resources and assets (Khanna & Palepu 2001, 45). Meyer et al. (2009, 64) argue that firms entering a market with a weak institutional environment need access to local resources, such as labour, raw materials and networks, in helping firms overcome challenges that arise from institutional voids. Conglomerates may hold access to the needed human, financial and technological resources and information through established reputation and trustful networks with key players such as government officials, managers and employees (Khanna & Palepu 1997, 48). Indeed, Khanna and Palepu (1997, 41; 2000, 269; 2001, 45) have found that diversified business groups may perform better in emerging markets than stand-alone firms. They argue that is due to the long-term commitment to the networks and nurturing of trustful relationships that may grant easier access to resources compared to a stand-alone firm. However, Schrammel (2012, 118) argues that connection to the networks of business groups may be challenging to obtain due to inward orientation of the business groups. Thus it is

proposed to seek partnerships within clusters of firms in similar or related industries that have been established geographically close.

In the presence of failing or missing market-supporting institutions it may incur significantly more costs to gather information, control the supply chain, access to capital or even find the right employees compared to a market with strong market-supporting institutions. Thus creating and nurturing networks or affiliation with business groups may help foreign entrants to overcome institutional voids and obtain access to intangible assets that stand-alone firms are hard to come by. Chang and Choe (1988, 155) argue in their study that firms affiliated with South Korean *chaebols* can expect a higher profitability compared to unaffiliated firms in the South Korean market. Moreover, Khanna and Palepu (1999, 274) argue in their study that South Korean business groups such as Daewoo and Samsung have exploited their scale and both internal and external relationships in order to compensate for the institutional voids of the South Korean market. Even though often found as inefficient, challenging to monitor and govern, conglomerates may fill some institutional voids in the capital, labour and product markets by imitating functions of failing or absent institutions. (Khanna & Palepu 1997, 41; 2000, 270.) For example, the Japanese business groups, *keiretsu*, traditionally perform e.g. banking services in addition to traditional business functions (Aoki 1990, 14-16; Khanna & Palepu 1997, 50) and business groups in Chile and India are argued to create significant value through acting as intermediaries in imperfect markets (Khanna & Palepu 1999, 273).

### 3.2.5 *Filling institutional voids*

Despite their impeding features, institutional voids can be viewed as sources of opportunities for entrepreneurs (Khanna & Palepu 2010, 16; Tracey & Phillips 2011, 29; Webb, Tihanyi, Ireland & Sirmon 2009, 7). Institutional voids can be overcome deliberately by establishing a business to fill a void, simultaneously “creating value by solving institutional problems” (Tracey & Phillips 2011, 24). Existing literature refers to this as institutional entrepreneurship (Tracey & Phillips 2011, 29; Phillips & Tracey 2007, 316). Firms facing an empty space have the opportunity to define “the rules of the game” (North 1990, 3) by challenging existing beliefs and traditions (Mair et al. 2007, 37). Webb et al. (2009, 15) argue that weakly institutionalized and underdeveloped formal institutions and inconsistent old and new institutions accelerate entrepreneurial activities in the informal economy. Thus opportunities to fill the voids often arise from the need to create a market-supporting function that a firm notices as crucial for the business (Khanna et al. 2010, 54).

In a market where the institutional structures to support the market and the society fail to perform their role as setting the rules of the game, the first actors to develop and enforce institutions to support the market should be the state or the government. If they are unable to develop and enforce institutions to support the market, business groups are argued to step in to fill the functions. However, if the market does not offer seeming potential to create financial value, large business groups may not view the market as viable, or they see the market as too risky to invest in. (Mair & Marti 2006, 37, 39; Mair & Marti 2009, 422; Khanna & Palepu 2000, 269; Khanna & Rivkin 2001, 49.) In these market situations institutional entrepreneurs are argued to step in and explore opportunities to fill the voids. Entrepreneurial individuals or firms take the role of performing the necessary functions themselves, if the state has failed in developing market-supporting institutions and business groups do not see the market as financially viable (Tracey & Phillips 2007, 30).

Individuals, small and large businesses, governmental actors and non-governmental organizations can be institutional entrepreneurs exploring opportunities to create competitive advantage and added value by filling empty spaces left by underdeveloped institutions. Institutional entrepreneurs often have to do what research calls bricolage, in other words, “making do” (Baker & Nelson 2005, 333) of the scattered and limited resources at hand in a challenging environment and combining them in creative ways to overcome limitations of the market (Mair & Marti 2009, 423; Mair et al. 2007, 39; Phillips & Tracey 2007, 316-317). In doing so, entrepreneurs can create completely new or more efficient market structures to e.g. production, distribution, and solutions, e.g. goods or services (Webb et al. 2009, 4). Thus the entrepreneurial firm may strengthen its position in the market and help in ensuring smoother business for other firms operating in the same market in the future, simultaneously creating economic value and competitive edge (Mair et al. 2007, 37). Moreover, entrepreneurs filling institutional voids can help develop the country actively in introducing and institutionalizing new legitimate practices (Tracey & Phillips 2011, 24).

Institutional entrepreneurship can also take the form of social entrepreneurship. According to literature, social entrepreneurship refers to a form of entrepreneurship where creating social value and spurring social development remains a primary or stronger goal instead of creating immediate financial value. However, creating financial value need not be excluded (Mair & Marti 2006, 37, 39; Mair & Marti 2009, 422). Similarly, as was defined in institutional entrepreneurship, social entrepreneurs also use and combine limited resources at hand creatively in order to address a social problem or spur social development (Mair & Marti 2006, 37).

Institutional and social entrepreneurship in institutionally weak markets involve ambiguity and risks, as the formal and informal institutional structures are not able to define “the rules of the game” (North 1990, 3; Tracey & Phillips 2007, 30). Moreover, the often rapid and undirected nature of change in the institutional structure of a

developing market is likely to cause inconsistency of formal and informal, or new and old institutions, increasing uncertainty about accepted practices (Hoskisson et al. 2000, 252; Farashahi & Hafsi 2009, 645). Institutional and social entrepreneurship can also spur political resistance from the governmental sector, as it may challenge or change existing structures and facilitate change in social status quo (Mair & Marti 2009, 433). Thus institutional and social entrepreneurs are argued to have a skill set that includes e.g. capabilities of creating legitimacy among stakeholders, building networks among different interest groups, creativity and previous experience (Tracey & Phillips 2011, 29; Phillips & Tracey 2007, 315).

### **3.3 Framework for overcoming institutional voids in North Korea**

This chapter has introduced the concept of institutional voids and how they affect the market and firms' business operations in the market. Moreover, possibilities to respond to and overcome institutional voids have been discussed. The framework for studying institutional voids follows a similar structure that has been developed for studying the institutional environment. It thus allows consistent mapping of the structures in the institutional environment first, followed by looking into the voids and lacking institutions within the identified institutional environment. Applying the same framework to both phases ensures comparability and consistency to map both institutional environment's structures and institutional voids on the market's context and on the market level. Thus the results are easier to follow and a consistent picture of the current state of the North Korean market structures and voids may be built.

For the purpose of studying institutional voids, North's (1990) concept of formal institutions is employed as a base. The framework developed by Khanna et al. (2005) and Khanna & Palepu (2010) for spotting institutional voids is adapted for the purpose of studying institutional voids in this study. The framework follows the components of the institutional environment presented in figure 2, and thus corresponds with the framework for studying the institutional environment. In the framework the *context of the market* is called macro context, and it is divided into political and judicial systems for the purpose of this study. Media was added as a category based on the framework from Khanna et al. (2005, 11-13). *The market* is referred to as the economic system, which is divided further into capital, product and labour markets. Moreover, some modifications were made. The social system was omitted as it represents informal institutional structures. As explained earlier, informal institutions such as culture, customs and traditions cannot have institutional voids as such due to their continuous nature that develops gradually without intention (Zenger et al. 2002, 283). Therefore, in this study, institutional voids are mapped only within the formal institutional environment.

The framework will be completed with empirical material arising from content analysis and expert interviews, which will be elaborated in more detail in chapter 4 as the methodological choices are discussed. The framework allows to explore institutional voids both on market's contextual and on the market level. In order to formulate an overview of the voids in the market, voids on both levels are important to take into consideration, as voids in the macro context are likely to affect the functioning of the market and vice versa. Thus it was seen as suitable for this study, as the market is seen a complex system of institutions that is deeply intertwined with its context (Mair et al. 2012, 820-821).

The possibilities to overcome institutional voids arise from previous literature, however no encompassing framework was found in previous literature. Thus the possibilities are discussed as such, and the data will be reflected to the theoretical insights provided in this chapter. Similarities and inconsistencies will be discussed. The possibilities to overcome identified voids are discussed in the same order in the results section as they have been presented in this chapter. Thus the findings and reflection are easy to follow.

## **4 RESEARCH DESIGN**

The purpose of the study is to identify institutional voids of the North Korean market and to find alternatives to overcome the identified voids. In doing so, it aims to create a holistic understanding of the current business environment in the country by using institutional theory as a tool to describe the market structure. Moreover, it aims to broaden the business environment- related research concerning North Korea. The study can be seen as a market-oriented study as it focuses on the market's and its context's structures. For addressing the first two research sub-problems, a theoretical framework was constructed that can be applied to both phases. In addressing the third research sub-problem, more firm-level strategic alternatives arising from literature to overcome institutional voids were discussed. This chapter aims to describe methodological choices from research approach and design to chosen methods of data collection and analysis. Moreover, a discussion of the research trustworthiness is provided.

### **4.1 Research approach**

The role of the research approach is to introduce the overall strategy of how the research problem is studied, thus linking the research problem to the empirical research (Eriksson & Kovalainen, 2008, 16). The chosen research approach, design and methods of data collection and analysis initially depend on the nature of the phenomenon or problem that is under scrutiny. Thus the research approach and chosen methods should be selected to serve the purpose of the research and stay coherent in the course of the study to best serve the aim of the research. (Eriksson & Kovalainen 2008, 27.) Methods provide an established logic to seek answers to the research problem, simultaneously describing how the answers are achieved and providing transparency to outside evaluators (Ghauri & Gronhaug 2010, 37).

This study follows a qualitative research approach as it is trying to describe and understand the North Korean business environment and find ways to overcome challenges presented by the environment. Furthermore, it aims to create a holistic understanding of the North Korean business environment by the collection and analysis of data. The qualitative approach was chosen as the research has no underlying hypotheses, theories or assumptions to test in a given environment or sample. On the contrary, the study aims to describe and explore the research topic in its natural environment despite its interference and possibly create alternate viewpoints, hypotheses or assumptions and gain a holistic understanding of the research topic. (Berg 1995, 2-3; Eriksson & Kovalainen 2008, 4-5.) The research question was evaluated as uncontrollable and non-isolable in the quantitative research manner. The issues and phenomena found in

the data are not taken out of their context and analyzed as abstract structures, as typically would be the case in quantitative research, but the data collection and analysis is conducted keeping in mind the significance of the phenomena's context. (Eriksson & Kovalainen 2008, 4-5; Guba 1981, 79.) This study employs qualitative methods of data collection and analysis for the descriptive and exploratory nature of the research problem. The choice of qualitative methods may help to gain deeper insights and structure the problem, which remains yet poorly understood. When the problem is not well understood, it may be challenging to establish clear determinants or measures to define to which direction the research finally leads (Ghauri & Gronhaug 2010, 106, 197). Thus a qualitative methods of data collection and analysis were chosen as it allows for more flexibility for findings that may not have been taken into account by the researcher.

The research design can be seen as the plan of executing the empirical research to get the wanted information and finally to arrive at answering the research problem. The design follows the type and interests of the research. (Ghauri & Gronhaug 2010, 69.) Research designs are often divided broadly into three categories. The causal research is suited for research where the problem is understood and has a clear structure, however concentrates on studying cause-effect relationships. The descriptive design is best suited for research which concentrates on a well-structured and understood problem that is interested in exploring certain characteristics of the problem. Exploratory design is best suitable for research problems that are poorly understood or lack structure. Often the interest is on finding possible explanations and hypotheses rather than definite answers to the research problem. (Ghauri & Gronhaug 2010,56-57.) This study includes both descriptive and exploratory elements. The descriptive design is seen as somewhat dominant and exploratory elements are used to arrive at answering the last research sub-question. Descriptive elements are used in exploring the structure of the business environment and institutional voids in the North Korean market. With describing the existing and lacking structures this study aims to build a holistic picture of the market's structure. The problem of how to overcome institutional voids in the North Korean market is yet rather unstructured, novel and unexplored. According to Ghauri and Gronhaug (2010, 105, 196), qualitative methods are of particular help in studying phenomena that are unexplored and not yet well understood, linking exploratory research closely to qualitative approach Thus this study applies a more exploratory approach in answering the third research sub-problem, seeking to find possibilities, deeper understanding of the phenomenon and bring up seeds of future research. Definite answers may not be found; however possible explanations are presented.

This study can be seen as theory-bound, referring to a study that is neither fully theory-nor or data-based. The analysis and reporting of the data are visibly linked to a theoretical framework adapted for this study, however they are not strictly bound. In this study the theoretical framework is used as a tool to view and organize the data, and thus naturally

its suitability is tested to some extent. Moreover, findings are reflected to the theoretical base. However, through data collection and analysis, this study aims to inductively build a broad understanding of the research topic, starting from small pieces of empirical data and proceeding to formulation of a broader description and understanding of the topic. (Eriksson & Kovalainen 2008, 22; Tuomi & Sarajärvi 2002, 99.)

## **4.2 Data collection**

In this study, the data collection involves qualitative methods of expert interview and systematical collection of news articles using content analysis. The two data sources were chosen to complement each other and thus allow a fuller description and exploring of the topic. Data can be collected from primary or secondary sources. Primary data refers to data that has been generated by the researcher for the purpose of the research by e.g. interviews, observation, experiments or surveys. Secondary data exists independent of the research and the role of the researcher is to collect it to the needs of the research. Secondary data may include textual data such as books, company reports or news articles, but also visual data such as videos and photographs. (Ghuri & Gronhaug 2010, 90, 99; Berg 1995, 174-175.) Thus both primary and secondary data are used in this study. It was established for this study that gathering primary data from North Korea would be a highly difficult task, as the country publishes information about its institutions and market rather scarcely and mostly in the Korean language. Moreover, the reliability of the information could be questioned due overall closedness of the country and possibility of obtaining data that has been produced with varying reporting standards or even manipulated.

Combining of research strategies, researchers, data or theories is widely referred to as triangulation (Hirsjärvi & Hurme 2010, 39; Ghauri & Gronhaug 2010, 2012). The use of both primary and secondary data, that is interviews and news articles, points to the use of triangulation of data collection techniques, resulting in data triangulation as well. Two sources of data collection methods were chosen as reliability and accuracy of information about North Korea remain challenging to establish. Thus the two kinds of data collected are meant to complement each other and provide information from different points of view (Guba 1981, 86). In doing so, the research strives for a more holistic and accurate understanding of the research problem that is not yet well understood. Triangulation also serves as a way to increase the overall validity and trustworthiness as well as confirmability of the study (Hirsjärvi & Hurme 2010, 39; Guba 1981, 86; Lincoln & Guba 1985, 305; Tynjälä 1991; 392).

#### **4.2.1 Documents**

Data from inside North Korea remains challenging to obtain as official statistics are generally not available and the trustworthiness of the information published to the outside world remains challenging to establish. In search of relevant information that would be accessible and as reliable as possible, written documents were chosen as secondary data source. Thus the sources of data include international online newspapers, research institutes and universities, books, blogs held by researchers and followers of North Korea and websites of foreign companies present in the North Korean market. Collecting articles from several sources internationally was seen as appropriate for the following reasons. First, information concerning the North Korean business environment remains scarce and thus it was seen as reasonable to include a wide variety of international sources that could complement each other. It was seen as a way to increase the credibility of the study as it involved triangulation of data: in addition to triangulation of methods of data collection, also multiple data sources were applied. Moreover, it aided in constructing as holistic a picture as possible. Second, collecting data from several sources with several cultural backgrounds can help to reduce possibilities for biased information. Having been produced by several participants of numerous nationalities - authors, experts etc. – in sources that are perceived as reliable internationally, it should help to convey a picture that reflects the reality as truthfully as possible. Third, different sources may publish from different angles and focus on different aspects. Thus it may help to gain a fuller understanding as the sources may complement each other. Put together with the interview data it achieves to help create a fuller understanding of the problem. The document sources are presented in table 3 based on the source types, featuring a descending order of the frequency of documents per source.

Table 1 Document types, sources and frequencies

Source type	Source name	No. of documents
Blog	38 North	8
Blog	North Korean Economy Watch	7
Blog	Choson Exchange	3
Blog	Koryo Tours	2
Blog	North Korean Leadership Watch	1
Blog	North Korea Tech	1
Book	Park, P. (2009) The dynamics of change in North Korea: an institutionalist perspective	1
Company webpage	GPI Consultancy webpage	1
Company webpage	Orascom TMT SAE webpage	1
Company webpage	Parazelsus Webpage	1
Company webpage	Phoenix Commercial Ventures webpage	1
Company webpage	PyongSu Pharma webpage	1
Newspaper/media	Asia Times	6
Newspaper/media	Yonhap	6
Newspaper/media	Daily NK	5
Newspaper/media	Financial Times	3
Newspaper/media	Chosun Ilbo	2
Newspaper/media	Forbes	2
Newspaper/media	NK News	2
Newspaper/media	Reuters	2
Newspaper/media	Xinhua	2
Newspaper/media	Associated Press	1
Newspaper/media	Bloomberg	1
Newspaper/media	China Economic Review	1
Newspaper/media	Computerworld	1
Newspaper/media	Handelszeitung.ch	1
Newspaper/media	Minyanville	1
Newspaper/media	NPR	1
Newspaper/media	The Asian	1
Newspaper/media	The Diplomat	1
Newspaper/media	Radio Free Asia	1
Research Institute/University	Institute for Far Eastern studies, Kyungnam Univ.	18
Research Institute/University	Peterson Institute for International Economics	2
Research Institute/University	East Asia Forum	1
Research Institute/University	German Asia-Pacific Business Association	1
Research Institute/University	Korea Development Institute essays	1
Research Institute/University	The Asia-Pacific Journal: Japan Focus	1
Research Institute/University	The U.S Central Intelligence Agency	1
Research Institute/University	The U.S Library of Congress country studies	1
Research Institute/University	U.S-Korea Institute reports, John Hopkins University	1
Total		95

The data included following documents: 40 articles from 19 international newspapers, 22 blog posts from 6 blogs concerning North Korea, 27 research articles from 9 research institutes and universities, 5 company webpages and 1 book. Thus altogether the data includes 95 documents from 40 different sources. The data sources are presented in full detail in Appendix 1. The seeking of relevant documents was commenced on blogs maintained by followers of North Korea. The author established that the information on the various blogs may lead to a snowball-effect to other relevant sources. Thus it was

established as the most effective way to seek data for the study. All the sources were scrutinized by practicing severe criticism, however, the blogs by North Korea followers were estimated as relatively reliable sources, as the followers were expected to have a history of following the market.

In the beginning, it is better to establish a rather broad category of relevant material than risk to lose relevant material (Schreier 2012, 83). Thus due to the scarcity and scattered nature of information concerning North Korea, a rather inclusive decision model was implemented in collecting the data to ensure as broad inclusion of sources as possible, however it should leave out data irrelevant for the aims of this study. Thus the model was created as follows: If the document concerns topics that affect the market's context or the market, the missing or lacking structures or intermediaries in the market or ways how firms may overcome the voids, it will be regarded as data suitable for this study.

The articles that remain within the timeline of 1.10.2011-31.12.2014 (3 years 2 months) were included in the data. A time span of three full years was established, with the addition of the time of the succession process, to allow gathering of sufficient data and provide basis for constructing a broader understanding of the research topic. The timeline was chosen as it aims to reflect recent development in the market, a topic that currently lacks contribution. The timeline was chosen to begin as Kim Jong-un was chosen the new leader, followed by a series of changes in the leading positions and in the institutional environment of North Korea. However, small amount of documents that did not fit the time span were included in the data as they relevantly concerned the topics specified in the heuristic model for data collection and were thus relevant for gathering information.

#### **4.2.2 *Expert interviews***

Theme interviews with experts were selected as an appropriate way to collect data for this study, as interview is seen as a useful technique when the research themes remain relatively unexplored and little is known about them. Thus the researcher may face difficulties in answering the research questions as they may take multiple and unexpected directions. Moreover, interview is suited for the purpose to obtain in-depth knowledge about the research topic. (Hirsjärvi & Hurme 2010, 35-36.) Thus it also suits the descriptive and exploratory design, because through interviews a wider more in-depth view can be formulated to holistically describe the phenomenon in question and find alternative viewpoints to a subject. Moreover, through interviews information could be obtained that allows the researcher to generate knowledge to describe the North Korean institutional environment in a more encompassing manner and explore possible alternatives how institutional voids may be overcome.

Expert interviews were conducted for the purpose of gathering data that may not have been accessed otherwise. Following Pfadenhauer's (2009, 81) definition, in this study experts are seen as individuals who have "privileged access to information", and thus hold detailed, extensive and/or exclusive knowledge that is generally not available openly. Information about North Korea is yet rather scarce and reliability of the information remains challenging to establish. Therefore, the experts could help the researcher to obtain information that may not have been available otherwise. Even though interviews are always subjective, it can be stated that they are based on first-hand experience and thus reliability can be increased in contrast to second-hand information. Thus the main objective of the expert interviews was to generate data for gathering knowledge and further reconstructing it in order to seek answers to the research problem (Pfadenhauer 2009, 84).

Bogner and Menz (2009, 46-48) identify three types of expert interviews with differing purposes. Exploratory expert interviews may be used in research where the topic is rather new, unexplored or lacks structure. Thus this type may be used as a tool to gain a clearer understanding of the topic and structure the elements of the problem, possibly leading to the generation of hypotheses rather than aiming to test existing ones. Systematizing expert interview is oriented towards collecting information that is based on the expert's experience and action in practice. Thus the role of the expert is to lend his knowledge to collect pieces of information that are seen as facts concerning the research problem. The theory-generating expert interviews aim towards gathering and analyzing subjective information of the expert and thus helping the researcher to formulate theoretical base. This study employs the systematizing and exploratory types of expert interviews. The systematizing expert interview was seen as suitable for the descriptive purposes of this study as it focuses on gathering hard-to-access bits and pieces of information rather than interpreting the expert's knowledge. Therefore, the systematizing expert interview serves the purpose of the first and second sub-problems of this study that are of rather descriptive nature. Accordingly, the first two themes of the interview follow the systematizing purpose of collecting missing pieces of information for further understanding of the North Korean institutional environment. The exploratory expert interview may be seen as suitable for the exploratory research problem and the third sub problem. The exploratory expert interview suits the third sub problem in gaining a clearer understanding of how to overcome the institutional voids of the North Korean market and is thus used in the third theme of the interview.

Sampling of relevant interviewees often poses a challenge when conducting expert interviews. Sampling measures differ from quantitative techniques, however, questions of who, how many, and to what purpose remain important. (Ghauri & Gronhaug 2010, 148.) The research topic and goal initially define who is seen as an expert with relevant knowledge. Thus a pool of clearly defined experts does not exist, of which a

representative sample could be selected (Littig 2009, 103). Especially when the topic is rather novel and of delicate nature, those who possess access to privileged information may not make themselves visible easily. This makes it more challenging to identify the experts and limits the number of possible interviewees. For this study, experts with exclusive knowledge and practical experience about North Korea were sought by the researcher through various institutes and through so-called snowball sampling, which refers to seeking experts through other interviewee's recommendations (Littig 2009, 103; Bryman & Bell 2015, 434). For this study, two interviews were conducted within the timeframe of 20.12.2013-20.2.2014. The interviewees stay anonymous; however some background may be provided. Both of the interviewees had done several professional projects North Korea, the other mainly in cities and the other also in rural areas. The interviewees are also active in different professional fields and both have an experience of visiting the country over several years. Thus they could provide different and complementary information about the institutions, structures and development of the country. Their expertise consists of a long engagement with the market, which is likely to have contributed to their extensive understanding of the market. The interviewees have acquired exclusive and practical knowledge of the country's institutions as they have initiated, learned and conducted projects in North Korea. Thus they are seen as experts with first-hand information that would not have been accessed otherwise (Pfadenhauer 2009, 81).

The first interview was 1 hour 22 minutes in length and resulted in a 15-page material when transcribed into text. The second interview was 2 hours 8 minutes in length and resulted in a 25-page material after the transcription. The interviews were conducted in Finnish language, which was the native language of the author and the interviewees. Some citations were translated into English language to be presented in the findings. Thus the author adhered to the utmost discipline and carefulness in translating the quotations, so that the message of the interviewees would not change. Both interviewees also conducted a member check to prove that information has been used correctly. The size of the sample can be considered as narrow, as it only includes two interviews. However, the length, depth, first-hand experience of the interviewees and complementarity of the information can be seen as balancing the narrow sample. Concerning the topic of this study, finding experts for the interviews proved challenging and thus the small sample of interviews was combined with written documents to provide enough data for credible and relevant findings.

Interviews can generally be divided into structured, semi-structured and unstructured categories (Hirsjärvi & Hurme 2010, 44-48). A structured interview refers most commonly to a survey questionnaire, where the same set of questions is presented to all interviewees in the same order. Here the underlying assumption is that the questions should cover all or nearly all of the relevant aspects of the phenomenon under scrutiny.

(Hirsjärvi & Hurme 2010, 44; Berg, 1995, 31.) Unstructured interviews allow freedom for the interviewee to direct the interview as general questions are formulated first and deepening questions are generated according to the answers the interviewee provides (Hirsjärvi & Hurme 2010, 45; Berg 1995, 32). A semi-structured interview is characterized by a predetermined set of broad questions or themes that are presented to all interviewees, however, the order of the questions and themes may be changed as the interview proceeds. The freedom to change the order of the themes and sub questions allows the interviewer the possibility to uncover themes that may not be found otherwise. (Berg 1995, 33; Hirsjärvi & Hurme 2010, 47.) This is especially suitable if the interviewees are expected to have more knowledge about the research topic than the interviewer, as may often be the case when conducting expert interviews. In this study, the semi-structured interview technique was chosen and more specifically, this study shall address it as a theme interview.

According to Hirsjärvi and Hurme (2010, 48) theme interview is a suitable when the research problem seeks to address basic characteristics of a phenomenon that remains rather unexplored. Thus the theme interview may help to bring up hypotheses rather than testing existing ones. What differentiates a theme interview from other semi-structured interviews is that themes are identified that build the spine of the interview (Bryman & Bell 2015, 484). Sub questions can be formulated in order to deepen the knowledge, and they need not be presented in the exact order or word form. (Hirsjärvi & Hurme 2010, 48.) Three themes were identified for this study that parallel with the sub questions of the research problem: institutional environment, institutional voids and possibilities to overcome the voids. Deepening sub questions were also formulated that could be presented if needed (See appendix 2). The themes were discussed with every interviewee, however in the absence of more exact questions the interviewee has more freedom to bring up his/her knowledge of all the related factors to the theme (Hirsjärvi & Hurme 2010, 48; Littig 2009, 105). Thus it may help to find information that the interviewee possesses but the interviewer may not have come about to ask.

## **4.3 Data analysis**

### **4.3.1 Content analysis**

In this study, the data extracted from the interviews and various online sources was analyzed with the systematical technique of qualitative content analysis. In general, content analysis can be identified as an analysis method aiming to study written or spoken language in order to understand a given phenomenon or problem (Seitamaa-Hakkarainen,

1999; Saaranen-Kauppinen & Puusniekka 2006). It is suitable for both written or visual data, and can be used on both self-collected documents or data collected from secondary sources (Schreier 2012, 3). It involves describing the content of the documents with the help of systematically constructed classifications either verbally, i.e. as concepts or numerically with the help of statistical analysis. Thus content analysis can be conducted as qualitative or quantitative or as a mixture of both. Quantitative content analysis usually involves analyzing the frequencies of specified expressions or words within the selected data and the results are presented statistically. On the contrary, qualitative content analysis is concerned with analyzing the content and meaning of the selected data, aiming to formulate a holistic understanding of the phenomenon or problem in question. (Seitamaa-Hakkarainen 1999; Saaranen-Kauppinen & Puusniekka 2006.)

Qualitative content analysis was seen as a suitable method of data analysis for this study as the aim is to describe the North Korean business environment and formulate a holistic picture of it and its voids, which leads to discussing possible ways to overcome the identified voids. Thus it has to do with understanding the contents and meanings. Moreover, qualitative content analysis was deemed as suitable for these aims for the following reasons. First, content analysis is an unobtrusive method, which should help in minimizing the researcher's influence on the subject or phenomenon in question. For example, in using methods such as observation, the fact that the subject is being studied may affect the information produced. Second, content analysis is suitable for processing unstructured data, as is the case in this study with documents collected from several sources, with several topics and producers. Thus the diversity of the data and individual voices are saved, and content analysis allows the structuration of the data later to enable effective analysis of the material. Third, content analysis takes into account the context of the data, implying that as parts of their social context, they are likely to represent the phenomenon they are linked to and which is of interest of the research. Fourth, content analysis is suited for processing large quantities of data due to its systematic procedures. (Schreier 2012, 3, 5-8; Krippendorff, 2004, 40-42.)

Qualitative content analysis can take three paths depending on how the classification of data is constructed. The data can be classified for further analysis based on a) categories that are extracted from theory and previous knowledge (concept-driven) b) categories that arise from the data (data-driven, grounded theory approach) or c) categories that arise as a result of interaction between theory and data. (Seitamaa-Hakkarainen 1999; Schreier 2012, 60, 84; Saaranen-Kauppinen & Puusniekka 2006.) Results can then be presented either as concepts or statistically. The chosen path is presented in figure 3, where the choices for this study are shown in grey colour.

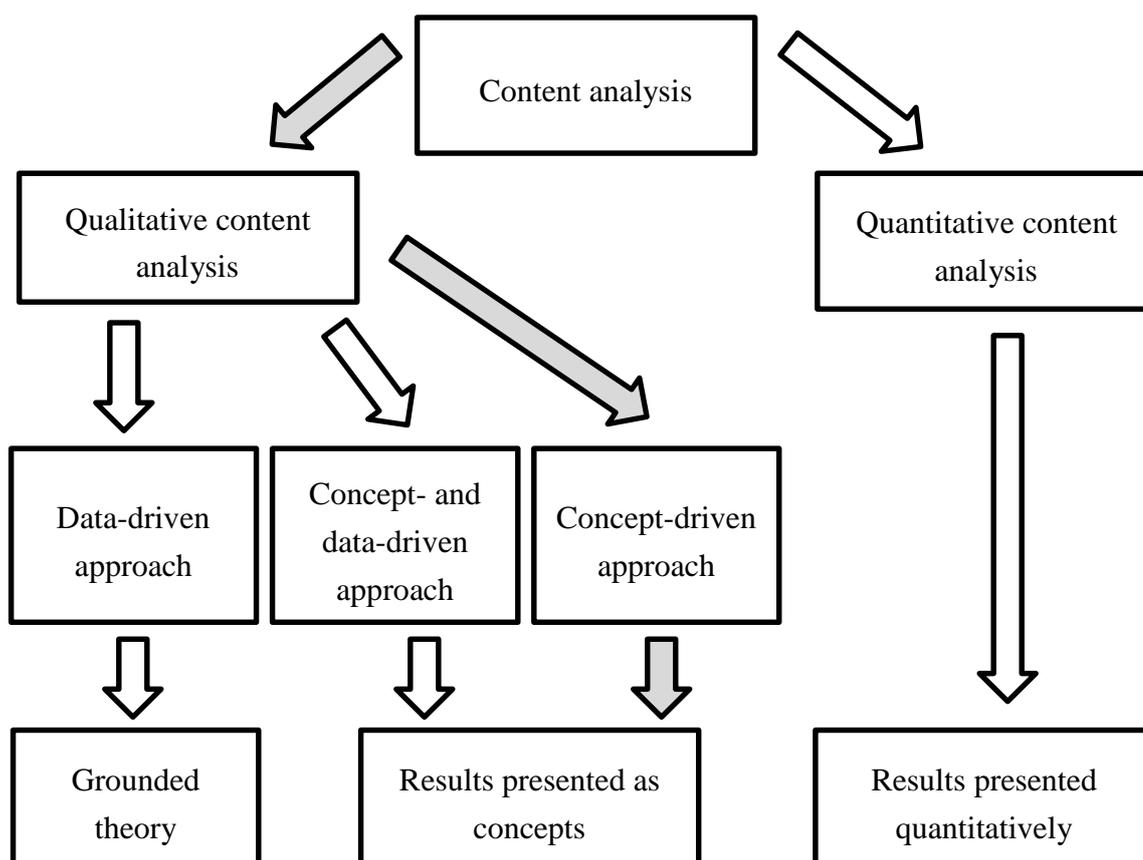


Figure 3 Content analysis structure (adapted from Seitamaa-Hakkarainen 1999)

In this study, the data was classified for further analysis in a concept-driven way, mostly based on main themes arising from sub -problems of the research. Then the data was coded based on a system arising from the theoretical framework. Moreover, the results are presented conceptually and discussed; thus this study does not involve the use of frequencies or statistical presentation of the results. Coding system remained the same throughout the study, however key units of analysis were added in the course of data analysis. That reflects the cyclic nature of qualitative content analysis: data collection and analysis are in constant interaction with each other (Seitamaa-Hakkarainen 1999).

Four general phases of content analysis can be distinguished when conducting content analysis in practice: (1) transforming the data into textual form, (2) developing a classification system, (3) defining the unit of analysis and segmenting the data and (4) coding and reporting of the data (Seitamaa-Hakkarainen 1999; Schreier 2012). Naturally, the selection criteria must be established before the data can be collected and analyzed. The selection process precedes the four steps of content analysis and was discussed in the chapter for data collection. (Berg 1995, 175.) If the data involves e.g. interviews, they should be transcribed to text for further steps of the analysis. In this study the news articles were already in written form and thus needed not be transcribed into text. Moreover, the interviews were transformed into text to allow analysis based on the classification system. The following chapters elaborate on the further three steps of content analysis.

### 4.3.2 *Developing a classification system*

The coding frame is a crucial part of the content analysis, as it allows the researcher to study the data by linking it to the main concepts of the research. Thus constructing the classification system should be done carefully. (Schreier 2012, 58.) The classification system arises from the purpose and nature of the research and thus each classification system is specific to the study in question. The classification system can be based on themes and categories arising from the research question and theory, or it can be developed simultaneously as the data analysis proceeds. The data may be processed several times in order to process the information and sort out relevant pieces of information. The pieces of information are assigned to themes and categories according to codes given to the data. Thus it allows to make sense of the data and group it to the needs of the study. New classes may also arise in the process of analysis. (Seitamaa-Hakkarainen 1999.)

The main interests of this study are reflected as main themes in the classification system, which is mainly developed in a concept-driven way, as described above. Table 2 presents the classification system for this study. In this study, the main themes of the operationalization table are derived from the sub problems of the research and thus reflect the broad logic of the study. This allows the data to be categorized to provide answers to the research sub-problems and finally answer the research problem. Further sub-themes and their codes are based on the theoretical framework constructed in the previous chapters. The third theme was left without sub-themes as it was rather unstructured with no clear previous research to formulate a theoretical framework. Thus it allows space for findings in the data (table 2). The theory serves as a lens or a viewpoint of studying the North Korean market and has been developed to provide more detailed tools to answer each research sub-problem. Thus it helps in organizing the data in a way that suits the themes of the study. The operationalization table also allows space for further themes or sub-themes if such should arise during the data analysis phase. This way of organizing data also helps in reducing large quantities of data – one of the advantages of content analysis – as a variety of relevant pieces of information are systematically assigned into fewer subcategories (Schreier 2012, 60).

The broad logic of the operationalization table and grouping of the data was to first pick the chosen sub-themes from the collected data (column three, table 2). This was done by reading each piece of data through several times and identifying the key units of analysis in the data that would correspond to the sub-theme (column four, table 2). Then the pieces of data were grouped into their sub-themes and coded accordingly to allow further analysis of the results. In the presentation of the analysis findings, the sub-themes of the data follow the main themes of the study (columns one and two, table 2).

Table 2 Classification system

<i>Theme</i>	<i>Level of the theme</i>	<i>Sub-system of the level/code</i>	<i>Key units of analysis</i>
<b>Institutional environment</b>	Macro context	Political system (PS)	Party, parliament, politician, leadership, cabinet, bureaucracy
		Judicial system (JS)	Constitution, courts, law, foreign investment, regulation, joint venture, amendment, tax, property right, intellectual property right, contract, adjudication, disputes
		Media (ME)	Newspapers, television, internet, telecommunications, advertising, marketing
		Informal institutions (INF)	Corruption, gender, culture, social change, middle class
	Economic system	Economic system (ES)	Formal economy, planned economy, informal economy, market economy, joint venture, special economic zone, economic development zone, banking, central bank, regional bank, investment, credit, insurance, production, distribution, education, school, university, employment, trade unions, labour unions, compensation, salary
<b>Institutional voids</b>	Macro context	Political system (VPS)	Bureaucracy, transparency, change, regulations, agreements, government interference
		Judicial system (VJS)	Responsibilities, change, role of the law, honouring contracts, ownership, land, real estate, regulation
		Media (VME)	Control, independent, internet, e-mail, telecommunication
	Economic system	Capital Market (CM)	Control, transparency, central bank, regional bank, investment, savings, loans, capital, credit, insurance, trust, stock market, venture capital, financial data, taxation
		Product Market (PM)	Informal economy, official economy, state distribution system, duality, regulation, law, transparency, provincial, municipal, country, wholesale
		Labour Market (LM)	Employment, relationships, motivation, skill, education, knowledge, manager, unions, compensation
			(OVER)
<b>Overcoming institutional voids</b>	Macro context Economic system		

In classifying the online documents, each document was coded into one or more sub-theme category. Also paragraphs or topics within one document could have their own codes and thus one document could be assigned to several sub-themes. The interviews were classified similarly, however due to their length and nature of containing several topics, each theme, topic, paragraph or sentence could be grouped to different sub-themes. The next two chapters will explain in more detail how the unit of analysis was chosen and how coding and reporting the data was organized.

### ***4.3.3 Segmentation, coding and reporting of the data***

The aim of content analysis is to find conceptual similarities within the data, comprising a category of units bearing similar meanings (Saaranen-Kauppinen & Puusniekka 2006). In order to organize the data to produce consistent and sense-making results, the data need to be segmented according to the defined units of analysis and then coded (Schreier 2014, 178). The data can be segmented based on semantic meanings that the units of analysis convey or based on the external structure of the data, e.g. pauses, specific phrases or words. (Seitamaa-Hakkarainen 1999.) In this study, the data is segmented based on the semantic meanings that the words or phrases (selected units of analysis) carry. The underlying logic is to gather information about North Korea, which is expected to be found not only in the external form of the data but more in the meanings the data and the units of analysis carry (Schreier 2014, 178). Thus attention is paid to the meaning of the text instead of the form.

Before the actual segmentation, the unit of analysis need to be defined. The relevant units can be e.g. words, phrases, chapters, ideas or concepts (Berg 1995, 182; Seitamaa-Hakkarainen 1999). In this study the extracted documents bear the relevant pieces of information and even a document, if concentrating on one aspect, could be regarded as a unit of analysis. However, the documents mostly contain information about several aspects and thus it was seen as necessary to define a smaller unit of analysis for the need of this study. Words and phrases are defined as units of analysis, as they can be expected to carry meanings clear enough to be categorized into the classification system. The identified key units of analysis are presented in the classification system (table 2). The data naturally contained more units of analysis that lead to the document to be assigned to its sub-themes, however, the most frequently found words and phrases are presented in the classification system. This aims to help the reader to understand the logic, based on which the data was grouped into their sub-themes.

The next phase of content analysis aims to group the data according to the chosen concepts by assigning certain labels or codes to the pieces of the data. The basis of the coding process is comparison of data: by finding differences and similarities it is possible to find units that carry similar meanings and can thus be coded under a specific category. (Schreier 2014, 178.) The codes represent the chosen categories and show under which category each relevant unit of analysis is assigned. Coding can also refer to memos written to the data in the coding process. The whole data should be coded under some category to prove the data's fitness to the research. (Seitamaa-Hakkarainen 1999.) In reporting the data, the segmented, coded and organized information is finally put together and the findings are presented as results to the research question. That refers to taking the unit of analysis is taken out of its original context, happening or phrase and linking it to the puzzle of the research as a piece of information (Seitamaa-Hakkarainen 1999; Saaranen-Kauppinen & Puusniekka 2006).

In this study, codes were assigned to the documents based on identification of chosen units of analysis in both articles and interviews. If a word or a phrase was directly linked to the sub-themes or contained a key unit of analysis, it was assigned a code of the respective sub-theme. Moreover, if the word or phrase in a document contained part of the chosen unit of analysis or conveyed a similar meaning, the document was assigned the respective code. Thus the coding was not dependent on only the themes and units of analysis chosen by one researcher, but allowed more meanings to be taken into account. In doing so, the influence of the researcher's view was limited in order to enable construction of a more real-life oriented understanding of the topic. As some articles discussed several themes of the study, more than one code could be assigned to one article. Moreover, as the transcribed interviews included 15 to 25 pages, codes were assigned whenever a word or phrase linked to the identified sub-themes was discussed. Thus each interview included several or all codes.

The documents were printed out for the purpose of coding. Memos and notifications were written in the coding process to notify the researcher of any finding or notions of importance or further discussion. Moreover, references to other documents were written, if noticed linkages, similarities, differences or contradictions. The results of the coding process can be seen in figure 4, which presents a sample document that has been coded according to the classification system. The codes contain two, three or four letters that best seemed to reflect the theme. As the first two main themes (institutional environment and institutional voids) contained similar names of sub-themes, the institutional void sub-themes were assigned a letter "V" to allow telling the sub-themes apart effectively. The documents were organized in a binder according to their main code to allow effective analysis and presentation of the data. The articles that contained several codes were used in the themes that they were coded to. In the coding process also some documents that

were included in the sample in the data collection phase were left out as they did not contain relevant units of analysis or were not linked to the sub-themes.

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**North Korea's rolling economic reforms**

Posted By Ruediger Frank On 24 September 2013 @ 10:00 pm In Development, Economic Policy, North Korea | No Comments

Author: Ruediger Frank, University of Vienna

While missiles and nuclear weapons have dominated the headlines, North Korea's economy under Kim Jong-un has been developing in promising ways on the domestic front.

The number of **booths** selling bread, soda, pingsu (ice water) and cigarettes has multiplied; they can be found at almost every intersection in Pyongyang, in provincial cities and in the countryside. In addition, many of the once-freestanding booths are now integrated into regular buildings. In provincial cities and the countryside, the booths still dominate; but there, too, the number of permanent and sophisticated commercial facilities is on the rise.

Those who find carrying thick bundles of money in their pockets uncomfortable can use **one of the two cash cards**, the red-blue Narae issued by the **Foreign Trade Bank** and the golden Koryŏ issued by **Koryŏ Bank**, in taxis and a growing number of shops.

The number of traffic lights replacing the iconic 'flowers of Pyongyang' (aka traffic ladies) has increased further, and small traffic jams are frequent. The highways are still empty but streets in the capital are now dominated by a great variety of modern passenger cars manufactured both at home and abroad. The number of yellow license plates, indicating 'private' ownership, is increasing. The old trolley buses, some of which have run millions of kilometres, are being replaced by new ones, manufactured in Pyongyang.

Moreover, **a sense of competition** has emerged. Companies owned by the state, military and co-operatives proudly display their brand names on new, gold-bronze painted signs. There are also more products on display and sale, and there are more customers with money. Pyongyang is taking the lead, but cities like Namp'o, Sariwŏn and Kaesŏng are following suit. **Prices are often horrendous**; three kilograms of apples cost as much as one (official) month's wages. But the fact that even exotic goods such as bananas are being sold is remarkable.

ES  
market economy  
informal economy  
FM  
bank card system

INF  
competition

ES  
price level

Figure 4 Sample coded article

The data was analyzed and reported qualitatively, and thus frequencies or other quantitative data was not reported. The researcher aimed to report, interpret and discuss the findings based on knowledge, theoretical framework and data information as objectively and holistically as possible. The triangulation of the data, relatively broad coverage of the data and previous acquaintance of the topic may have helped in reporting the data in a holistic manner. In reporting the data, the units of analysis, or pieces of information were moved from their original source to provide answers to the research problem. However, it can be argued that despite interpreting the information for the research purpose, the meaning and context of the data was meant to stay relatively similar than in their original sources. That is due to the research aiming to formulate a holistic understanding of the research problem based on the data as it is, and not alter the data for the research purpose in any way. In grouping the pieces of information according to the theoretical framework, they could also be moved to a more abstract and theoretical level and used for the purpose of the research to reflect the data to the theoretical concepts.

## 4.4 Establishing research trustworthiness

In evaluating the trustworthiness of a research, several sets of criteria may be applied depending on the nature and underlying assumptions of the research (McKinnon 1988; Lincoln & Guba 1985; Mäkelä 1990; Tynjälä 1991). Traditionally, the criteria of validity and reliability have been applied in the school of quantitative research (Guba 1981, 79). However, the direct applicability of those criteria in qualitative research has been debated on as the quantitative and qualitative school, even though not mutually exclusive, are often argued to represent different paradigms and thus address different aspects of e.g. nature of knowledge, objectivity and truth (Guba 1981, 79-81; Tynjälä 1991, 388). This study applies qualitative approach and methods, however, content analysis is often evaluated with the traditional criteria more commonly used in evaluating quantitative research. The set of criteria largely developed by Lincoln & Guba (1985) are seen as appropriate for this study, as they are seen to represent modifications of the traditional measures that are developed to take into account the aspects of qualitative research (Tynjälä 1991, 390, Guba 1981, 79).

### 4.4.1 *Credibility*

Credibility corresponds with the traditional criterion of internal validity. It measures how well the reconstructions of the research reflect the constructions of the reality (Tynjälä 1991, 390). Here it is appropriate to talk about constructions of the reality instead of objective reality, as it can be argued that in qualitative research the concept of one objective reality is often abandoned. Instead, it is argued that realities can be many and research may produce one view of the phenomenon under scrutiny. (Tynjälä 1991, 390.)

The evaluation of data can be seen as a crucial theme in this study, as the data may be expected to have an influence on the constructions of reality in this study. Information for the study remained scarce, scattered and constructed by a variety of authors. Thus the transparency concerning innate attitudes, purposes or goals of the data need to be discussed transparently. Data from North Korea was abandoned as a data source due to its scarcity, difficulty to obtain and problematic reliability. As readily processed information was not available for this study, it had to be gathered from several sources as secondary data and complemented with primary data. Thus the quality of the data is to be scrutinized with care. The constructors of secondary data are likely to experience lack of information and trustworthiness in the construction of their documents. Moreover, different authors and sources may have different views, even biases or hidden motives that can influence the quality of the data in such controversial topics over which not much is known. Thus it remained the task of the author to conduct data collection and analysis

with severe criticism and evaluate the sources carefully. Therefore, reputable newspapers were sought to ensure high standard of source criticism. Moreover, blogs by followers of North Korea and documents of research institutions were used to capitalize on the expertise, understanding and criticism the followers and researchers have gathered over time. Despite the effort, the data is likely to combine a variety of views and may have internalized opinions and biases due to the variety of authors and their backgrounds. Moreover, sources remained scarce for data collection, however simultaneously a little-explored topic demanded for a wide variety and amount of data to be trustworthy and provide credible reconstructions of the phenomenon. This may cause a conflict of source criticism and sufficient amount of data for the study. Thus it was decided for this study that a possibly wide range of data should be included practicing severe criticism on credibility of the content. A wide range and triangulation of data were evaluated to include a variety of views in the data, which would balance the views and lead to as realistic a picture of the phenomenon as possible.

In this study, three measures were taken in order to increase the credibility of the study. Prolonged engagement refers to the researcher being engaged with the topic long enough to build an understanding of the culture that the phenomenon is embedded in. It is argued that any phenomenon is linked to its context and therefore understanding the context is important in building credible representations of the phenomenon. (Lincoln & Guba 1985, 302.) The author has followed the Korean peninsula for some seven years and spent a year in South Korea. The Koreas share a thousand-year-old history and thus by learning the language and way of thinking in South Korea can be argued to provide a basis for understanding the North Korean culture as well. Naturally the countries are in very different situations at the moment and after the Korean War the North Korean culture has evolved. However, the history of unified Korea is tremendously longer than that of the divided Korea, suggesting that the countries still share a common cultural basis. However, the author has not visited North Korea and thus has not been able to make observations of her own. It can be seen as a disadvantage in this study, as representations of the phenomenon are based on the author's evaluation of other people's experience. However, given the difficulty of entering North Korea and gaining access to people and businesses there, gathering other people's evidence from the country was seen as the next best possibility given the limited time and resources of this study. Moreover, based on the contextual and cultural understanding the author has gathered, the data has been gathered and analyzed as carefully and critically as possible.

Triangulation is another technique to improve the achievement of credible reconstructions and findings (Lincoln & Guba 1985, 305; Tynjälä 1991, 392). As presented in the chapter of data collection, this study employs triangulation of data collection techniques and data sources. Triangulation serves as a way of verifying the data from several sources and thus increases the credibility of the representations and findings.

In this study, triangulation was seen as an important tool to gather a sufficient basis of data and check different sources of data to avoid distortions that one type of data may contain. Verification in the analysis phase may be done by comparing several samples of the same type of data (e.g. comparing articles from different newspapers), or by comparing several types of data on the same information (e.g. comparing documents with interview responses on the same topic). In this study, both kinds of comparison were undertaken within the limits of found information.

Member check refers to letting the original sources of the information check the reconstructions and findings of the study. It serves as a way to assess, whether the researcher has been able to create reconstructions that represent the realities of the data sources. In fact, Lincoln and Guba (1985, 314) see member check as the most crucial part in establishing credibility. To enhance credibility of the study, a partial member check was done. Interviewees were given the chance to evaluate the findings and provide comments. This served as a way to correct possible factual errors, find possible misunderstandings and misinterpretations, give the interviewees a possibility for adding information and finally, putting the respondents into a position of recognition of the provided information and the researcher's interpretations of the information (Lincoln & Guba 1985, 314).

#### **4.4.2 *Transferability***

Transferability reflects the traditional concept of external validity. It refers to how well the results of the research can be transferred into and applied to other empirical and theoretical contexts (Guba 1981, 79). In the quantitative school, findings have been held as relevant, if free from changes over time and situations. However, it is argued that all findings are related to their time and context and thus can be relevant, even transferable (Guba 1981, 81). However, the transferability of the results partially depends on how similar the researched phenomenon is with the one in comparison (Miles & Josefowicz-Simbeni 2010, 421). As the researcher is often most familiar with the phenomenon of the research, it is partially left for the reader to evaluate the transferability of the research results. Therefore, it is of great importance that a thick description of the research process and data is carefully provided. (Tynjälä 1991, 390; Lincoln & Guba 1985, 316.) If significant similarities can be found in both topics after a thick description of the topics, transferability may be assumed (Guba 1981, 80). It is the researcher's responsibility to provide a data base and analysis as comprehensive as possible for thick description of the data, so that the phenomenon in question can be described in a sufficiently detailed manner. Only so potential evaluators can gain an understanding of the potential applicability of the study. (Lincoln & Guba 1985, 316.)

The transferability of this research was enhanced by providing as thick a description of the phenomena taking place in the North Korean market as possible within the limits of resources and understanding of the researcher and available data. Moreover, the researcher attempted to address phenomena and structures that the data did not cover sufficiently. Thus the reader may establish that those findings may be insufficient for transferring to other contexts. Moreover, in the absence of previous studies concerning the same topic, the research results were compared to the theoretical framework arising from previous literature concerning somewhat similar phenomena in different contexts and times. In the very end of the results, it was speculated, what kind of organizations could potentially benefit from the results and have the ability to overcome the voids in the market.

The transferability of the results of this study to another context or even another time within the same context may be questioned to some extent. The market, its institutions and voids are under constant development and thus bound to change over time, albeit to a varying degree and pace. Moreover, especially in the case of a market as unique as North Korea, the overall structure and development of the market may be seen as culturally bound, thus decreasing the applicability of the results in cultural contexts different from North Korea. However, developing markets may show similar development and challenges regardless of the culture. Thus by providing as rich an amount of data and a thick description of the research process as possible the applicability of the research findings in other developing market contexts are increased.

#### **4.4.3 *Dependability***

Dependability corresponds with the traditional criterion of reliability and refers to the independence of the results from the research setting (Miles & Josefovicz-Simbeni 2010, 422). It essentially addresses the consistency of the findings and aims to present that the stability of the results is not dependent of the research setting (Guba 1981, 81, 86). In the quantitative school, instruments and research setting may be isolated from their context in a different manner than in qualitative research, which largely aims to take into account the context of the phenomenon. Thus qualitative research naturally includes a certain degree of influence of the research setting that stems from the acceptance of multiple realities and humanly variations of condition, opinions and nature. (Guba 1981, 86-87; Miles & Josefovicz-Simbeni 2010, 422.)

In this study the use of two overlapping methods of data collection were used to complement each other and thus increase the dependability, that is to prove the independence of the results from the research setting (Miles & Josefovicz-Simbeni 2010, 422). Both articles and interviews were gathered to see to which degree they would yield

similar or conflicting findings. The two data sources yielded indeed results that strongly complemented each other and pointed to similar conclusions. Thus a discussion between the articles and interview quotes could be established in the results section. Therefore, it can be established that the findings are relevant in the light of dependability, even if the context and time of the research play a role in understanding the structure and phenomena of the North Korean market.

To increase the dependability of the study, the researcher aimed to provide a sufficient “audit trail” by describing in detail the process of selection, collection and analysis of the data. Thus any external auditor or reader may be able to follow the process of conducting the research and thus evaluate, whether the results depend on the research setting or prove stability and dependability. (Miles & Josefowicz-Simbeni 2010, 422.) The research approach was described to provide understanding of the basis on which the research is established. The data collection process using two methods was described with details of how, why and when the data was collected. Thus the description provides tools to assess the independence of the data collection process from the research time, context and setting. For the same reason a detailed description of the data analysis was presented with explaining how the different steps of content analysis were processed in the course of this study. A classification system was created for the purpose of gathering, classifying, coding and presenting the data, however it also aims to help the reader to establish the consistency of the findings as they can be reflected to the theoretical framework created by renowned scholars.

#### **4.4.4 Confirmability**

Confirmability refers to the traditional concept of objectivity and thus it touches the aspect of the neutrality of the research (Guba 1981, 80). As argued above, it is often not the purpose of qualitative research to strive for objectivity as an only truth (Miles & Josefowicz-Simbeni 2010, 422). Instead, the phenomenon is viewed from a chosen viewpoint, which reflects the idea of multiple realities (Tynjälä 1991, 392; Guba 1981, 87). Thus the findings may be subject to cultural, ethnic or contextual multiple truths, which suggests moving away from establishing the researcher’s neutrality to establishing the neutrality of the data. Therefore, the qualitative confirmability can be established by presenting the objectivity of the data and the possible underlying assumptions that the researcher may have concerning the research (Guba 1981, 87).

In this study the triangulation of two data collection methods served as a way to increase the credibility and dependability of the study and findings. Moreover, Guba (1981, 87) suggests that triangulation increases the confirmability of the results as well. The neutrality of the data can be increased and checked in collecting it with differing methods,

in different times and from different sources as was done in this study. The data includes various views and perspectives and therefore questions any biases the researcher may hold. Moreover, multiple views were taken into account and presented in the findings and neutrally as possible. Thus the multiple realities, voices and contexts of the data were saved and brought into the study, further allowing a holistic and neutral presentation of the data and the structure and phenomena of the North Korean market.

The researcher should be aware of and present their own assumptions, reasons for conducting the research, even biases (Guba 1981, 87). In this study, the author's viewpoint concerning the topic of the study is visible in choosing the research questions, as well as in the underlying manner the North Korean market and the phenomena of institutional voids are handled. The author recognizes a tendency to give space to opportunities in the North Korean market, however it was a consciously chosen viewpoint for the purpose of this study. This is an important recognition since if left unrecognized, it may lead to a hazard of selective gathering of overly positive data, leading to creating a utopist, unrealistic view of the phenomenon. However, the representations and findings concerning the market structures and phenomena are deemed to be based on a sound data basis that the researcher strived to gather as objectively as humanly possible. Thus the findings of this study aim to consider both challenges and opportunities, however concentrating on how to overcome challenges to make use of the opportunities in the North Korean market. Moreover, in their respective chapters it was explained carefully, why the chosen theoretical frameworks, research approach and design, data collection, analysis and reporting were chosen and seen as suitable for the purpose of this research. Thus the research process is visible for the reader and the investigator has aimed to explain all the different phases of the research as carefully as possible.

## **5 OVERCOMING INSTITUTIONAL VOIDS IN THE NORTH KOREAN MARKET**

### **5.1 Institutional environment in North Korea**

This chapter aims to discuss and describe the institutional environment of the North Korean market. Simultaneously it aims to answer the first research sub-problem: *What is the institutional environment in North Korea like?* First the institutional structures on the market's contextual level are discussed, followed by discussion concerning the institutional structures on the market-level. Finally, a synthesis is provided.

#### **5.1.1 Macro context of the market**

The macro context in this study refers to the political and judicial systems as explained in the theory chapter. The focus of this study lies in the North Korean market from an economic point of view, and thus it is seen as justified to present the economic environment separately. The macro context provides the structure for the economic environment, however, it is to be noted that the economic environment interacts significantly with the political and judicial environments.

##### **5.1.1.1 Political system**

The basis of North Korea's political system is the single-party system. The head of state is Kim Jong Un since December 2011, currently holding the positions of the first secretary of the Korean Worker's Party (KWP), first chairman of the National Defense Committee (NDC) and supreme commander of the Korean People's Army. (KPA) (CIA World Factbook: North Korea 2014.) Some minor parties exist that are under the government of the KWP. The country is divided into nine provinces and two municipality-level cities. Government system is divided into three levels. The first level consists of the nine provinces and two municipalities. The second level includes cities, districts and counties and the third level consists of villages. The cities are further divided into wards and neighbourhoods, which represent the lowest level of local governing bodies. (CIA World Factbook: North Korea 2014.)

The Supreme People's Assembly (SPA) is North Korea's parliament. The SPA consists of 686 seats and the members are elected for a 5-year term. The 13<sup>th</sup> SPA was elected on March 9<sup>th</sup> 2014. The main role of the SPA has been seen to be the passing on

of decisions and legislation and it has been criticized of being a rubber stamp for the political system. (Frank 2014a.) However, Frank (2014a) illuminates the underlying logic of why the elections are held and of the internal role of the SPA. Instead of viewing the SPA as puppets of a rubberstamp parliament, it may be reasonable to view it as an institution which provides an arena for internal competition for ambitious politicians. Moreover, it serves as an arena for regional rivalry and influencing local matters under the surface. In a system that is known for having one official party, often one candidate per seat and a voting percentage close to 100%, the role of the SPA elections differs from the Western view of a political competition for the voters' support. In North Korea, the emphasis lies on the selection process of the candidates instead of the actual election. As it requires loyalty, networking and ambition to be selected as a candidate by one's superiors, the SPA elections serve as an arena for internal bureaucratic competition. The SPA members' influence is visible in smaller, more local issues. The members may promote the role of their home region, which also serves as a way of presenting loyalty to those who selected them. (Frank 2014a.) The 2014 SPA session was conducted without larger surprises. However, some developments were noteworthy as they reflect the emphases of the current leadership. The economic and nuclear development (*buyngjin*) continued as a theme and seems to be one of the main guidelines of the regime. For the first time the revenue from the special economic zones and economic development zones was reported, which can be seen as an emphasis on economic development and acknowledging the importance of FDI. Sports was highlighted as a rapidly growing field, which supports the ongoing development of the leader's interest in sports and utilizing sports as a tool for diplomatic relations. (Frank 2014b.)

Cabinet is led by the Premier Pak Pong Ju. The cabinet members are appointed by the SPA. Since Kim Jong Un took power in 2011, the role of the cabinet is estimated to have increased in economic and national matters as opposed to the military and the party (NK trade-cabinet 2013). During Kim Jong Il's regime, the party and the military held tighter control over the economy and national affairs, which is seen to be related to the military first-policy of the late leader. However, the shifting of power over economic and national affairs to the cabinet seems to be in line with Kim Jong Un's policy of building a stronger economy and nuclear capacity (*buyngjin*) (NK Briefs 140219). It is estimated that the tight control of the military and party over the economy were seen to slow down the economic development sought by Kim Jong Un. (NK Trade-cabinet 2013; NK Briefs 130404, 2013.)

Following the focus on the economic development, bodies responsible for economic activities have seen changes. The State Economic Development Commission (SEDC) was established in 2013 as a new body to oversee the development, management and activities related to the special economic zones except for the Kaesong Industrial Zone. The SEDC is a body directly under the cabinet. (Babson 2013.) The Daepung Investment

Group formerly responsible for attracting FDI was dissolved and merged under the Joint Venture and Investment Committee (JVIC) in 2012 due to overlapping functions (NK Briefs 120229). The JVIC also has a branch in Beijing (NK Briefs 120727). The main tasks are estimated somewhat controversially in the data. One article reports the main task to be the overseeing of FDI into North Korea aside from the Special Economic Zones (Babson 2013). On the other hand, another article reports the main activities to concern the Special Economic Zones of Hwanggumpyong Island and Rajin-Sonbong (Rason) (NK Briefs 120727). This reflects the challenges in obtaining accurate information from North Korea that makes it challenging to accurately present the responsibilities of several bodies, or to even recognize all the bodies within the system. Thus it also suggests that the system is very complex and likely to have bodies with overlapping functions that are subject to changes. Naturally for a foreign company to conduct business in North Korea, it would be highly useful to know accurately of the bodies responsible for the country's economic activities. However, in the context of North Korea, it may be more fruitful to look at the overall direction of development instead of specific bodies, their functions or leaders. The restructuring and establishing of bodies reflect the emphasis on economic development and efforts to build structures to support economic development. However, simultaneously the changes cause uncertainty and complexity in the institutional structure, as different institutions may overlap and remain unspecific in functions.

#### ***5.1.1.2 Judicial system***

North Korea's constitution was established in 1948 and revised in 1972, 1992 and 1998 (Yoon 2009, 45; CIA World Factbook: North Korea 2014). The court system is suggested to have three levels (Country Profile: North Korea 2007, 14-15), the Central Court being the highest organ, provincial courts at the second level and people's courts at the third level. The existence of municipal, military and special courts is added. The judges for the Central Court are selected for a 5-year term by the SPA. (CIA World Factbook: North Korea 2014.) For the current study, no data contained detailed information of the tasks and responsibilities of the court system. Considering that also topics concerning judicial system and laws were included in the data collection process, it may reflect that detailed information about the judicial system is yet challenging to find. However, this study has an economic emphasis and thus a study concerning the judicial system may yield more accurate results.

The law on foreign investment was first promulgated in 1992. It includes laws and regulations concerning e.g. equity and contractual joint ventures, foreign-invested banks, leasing of land, taxation of businesses and individuals, dispute settlement and arbitration and bankruptcy of foreign businesses. The law permits foreign investment in forms of

equity and contractual joint venture. Moreover, wholly owned enterprises are permitted in the Special Economic Zones. (The complete guide to North Korea investment laws 2014; Law of Hwanggumpyong and Wihwado Special Economic Zone 2011, 1; Thompson 2011, 42.) However, in the current study the data contained no examples of wholly owned enterprises. This indicates that joint venture is a dominant mode for entering North Korea, which corresponds with scientific literature on the point that a local partner is a significant part of doing business in emerging, developing and difficult markets (Ferreira et al. 2007, 14; Xu & Shenkar 2002, 614; 296; Meyer & Nguyen 2005, 75).

Yoon (2009, 64-65) suggests that mechanisms for handling disputes were largely underdeveloped due to the nature of the socialist system. Under a system which strongly restricts transactions between individuals through ideology and organizational structure of the society, disputes between individuals or between an individual and an organization would be rare. Despite the emerging private economic activities and encouraging of foreign investment into North Korea, the data does not support emergence of a mechanism for dispute settlement. This can be extended to concern firms, especially foreign, in North Korea as well. In a system which does not allow private ownership and companies are owned by the state, disputes may have been handled internally without specific mechanisms for dispute settlement, as is common in the Western culture. Thus in the case of a dispute between a foreign company and North Korea, disputes may be expected to be settled by the parties involved.

According to the data, new laws have been passed and existing ones revised since Kim Jong Un took power in 2011. The amendments and new laws are likely to reflect the strive to build a stronger economy and present effort in attracting foreign investment, however they remain small in scale and actual direction of changes remain uncertain. The amendments found in the data concern foreign investment, special economic zones and their governance, renewable energy, law on advertising and railroad transportation. Also intellectual product regulations were reported to have been established. (NK Briefs 120216, 2012; NK Briefs 131129, 2013; NK Briefs 120404, 2012; NK Briefs 120927, 2012; NK Briefs 130917, 2013; NK Briefs 131108, 2013; NK Briefs 121122, 2012.) The set of laws on foreign investment include revision of e.g. foreign investment bank law, presenting income tax exemptions for foreign businesses. Moreover, foreign investment laws on company registration, bankruptcy, labour and financial management were amended, however further details of the amendments were not reported. (NK Briefs 120216, 2012; Kim 2012.)

The Special Economic Zones and Economic Development Zones are promoted as investment-friendly zones and some details concerning legal ground for the zones were found in the data. Within the law concerning Hwanggumpyong and Wihwado Economic zone, investors' rights were mentioned to be protected as follows: "the property, legitimate income and invested rights of investors in the Zone shall be protected by the

law. The State shall not nationalize or expropriate the property of the investors.” Moreover, the law contains details over administration and establishment of business, taxation and labour (NK Briefs 120404, 2012.) Favourable taxation, freedom over managing businesses, less restricted communications and enhanced access to finance can be seen as signs of willingness to reduce risks and promote confidence in the ability of doing business in the zones (Babson 2013). Law amendments concerning Rason SEZ in 2010 and 2011 can be seen to indicate an effort to create a more autonomous investment environment that would meet the needs of foreign investors, intending to imitate the Chinese model of investment laws (Whitehead 2013). The Special Economic Zones and Economic Development Zones will be elaborated in more detail in chapter 5.1.3. on economic system.

The role of law in North Korea differs significantly from that of the role in the Western countries. Traditionally, the North Korean society has been governed by moral codes stemming from the socialist structure of the society and lifelong indoctrination to the one-man rule (Yoon 2009, 72). Moreover, the Confucian tradition is likely to have its bearing on the society. Thus the party’s directives and teachings of Kim Il Sung and Kim Jong Il are still estimated to have stronger impact on the society than the law (Yoon 2009, 54-55, 72). Therefore, the law is expected to have a relatively low enforcement power also in business and often the role of law is to recognize or legalize already existing activities. Thus the legal framework to attract foreign investment lacks credibility. However, even though the status of the law as an effective governing system is still rather weak, the need for legal framework in governing the society and business may be increasing. The significance of the indoctrination and socialist moral order has faded to give way to a more transactional and individualist approach that has followed after the socialist system failed to provide livelihood for the people since mid-1990s. (Yoon 2009, 72-73.) Thus the legal framework is being developed to correspond with the changing economic environment and increasing economic activity. Moreover, North Korea seems to recognize the need to create a credible and effective legal framework in order to attract foreign investment.

The data concerning foreign investment laws at hand for the current study were scarce and experience-based analysis was not found. However, the data at hand gives a sufficient background for understanding the components and role of the law concerning foreign investment in North Korea. Within the economic focus of this study, the conclusion can be made that the changes within the legal system reflect a certain degree of political willingness to develop the legal framework towards conformity to the international standards. could be recognized by foreign investors in the future. It would be exaggerated to talk about reforming the judicial system, however the revisions So far the revisions are small in scale and their effectiveness remains uncertain. However, they reflect testing and learning, which is a sign that should not be underestimated. Beyond economic scope, the

law may also rise as a societal governing body due to the weakening of the traditional control mechanisms of the state over the people. At the moment it can be argued that North Korea's legal system is undergoing efforts to support the economy, although the rule of law still remains weak.

### 5.1.1.3 *Social change*

North Korea is also facing social change that has largely gone unnoticed in the international media (Lim 2013; Rohulich 2013; Lankov 2011a). A growing middle class of *donju* is emerging in a country that used to be divided into a small elite and common people (Frank 2013; Rohulich 2013). The ongoing private economic activities have allowed entrepreneurs to make use of opportunities of earning income, although by all measures, North Korea still remains a highly poor country (Lankov 2012b). This is slowly bringing a change in the way of people's thinking, even though the country is still officially controlled by the socialist and bureaucratic order and ideology. Lankov (2011b; 2012a) argues that North Korea still keeps up a strongly socialist image of itself, but the society under the image is no longer socialist. The fact that the state has long been unable to provide a living to the North Korean people together with a growing middle class that has earned its income from private economic activities have caused that the grounds of the socialist ideology and inbuilt obedience towards the authorities are slowly changing. (Lankov 2011b; 2012a.), This it is clearly visible in the capitalist practices of the informal market. People are relatively aware of what is happening also outside of North Korea (Rohulich 2013) and have the ability to put the socialist system and ideology into perspective. Thus the ideology, slogans and personality cult are likely to decrease their effect, at least under the surface.

At the same time as the middle class is emerging, differences between the capital and the countryside and between the poor and the rich remain large. Interviewee 2 (Interview 2 20.2.2014) notes that the significant purchasing power remains in the capital city, where a wide variety of products are available to anyone with purchasing power. However, in smaller cities and villages people try to secure their livelihood by selling e.g. eggs, peanut and sunflower seeds on the market. People are also becoming increasingly familiar with Western style of clothes, grocery products, electronics etc.

Simultaneously a social change related to genders is taking place. Traditionally, women were mostly excluded from key state sectors in the official economy, as it was seen as a business of the party and state that men were primarily responsible for. However, with the state being long unable to offer jobs and salaries that are barely enough to buy a kilogram of rice, women have engaged in entrepreneurial activities out of necessity to earn the family's living, while men are still bound in the official sector. (Lim 2012.) In a

study conducted in Ewha Women's University in Seoul, it is estimated that in 80-90 per cent of the North Korean families, women earn the majority of the income. The situation is estimated to affect the family life vastly as women have more power, however men face frustration over the decreasing of the traditional role (Lim 2012). Recently, women have shown growing activeness in the restaurant and service business of the emerging small and medium -sized business sector (See 2014.) However, the reality is likely to be more complex as it is estimated that majority of the North Koreans are involved in the informal economy. Men are estimated to be able to participate in private economic activities by e.g. paying their official employer or doing small-scale business beside the official work (Lim 2012; Rohrllich 2013).

#### ***5.1.1.4 Media***

The main media in North Korea are the country's official news agency Korean Central News Agency (KCNA) and the Worker's Party's official newspaper Rodong Sinmun, which represent the government and the party (Lankov 2012c). Both Associated Press (AP) and Reuters have established presence in the country, however foreign journalists are likely to remain restricted (Jaffer 2012). The AP has had a video bureau in Pyongyang since 2006 and since 2012 has a North Korean reporter and photographer in the office established in cooperation with the KCNA. Moreover, international staff is expected to visit Pyongyang regularly. The actual independence can be questioned to some extent due to the cooperation with the KCNA, however at the moment cooperation remains the only option and is likely to be better than no coverage. (Williams 2012; Daniszewski 2012.) Internet access remains restricted as a fraction of the North Koreans have access to the country's intranet and an even smaller group of the citizens have access to the internet (Rohrllich 2013). However, mobile phones are common in Pyongyang and other larger cities and have become a must-have item not only for the emerging middle class but also for ordinary North Koreans. The country's 3G mobile network Koryolink was launched in 2008 as a joint venture between an Egyptian telecommunication company Orascom and North Korea's Korea Post and Telecommunications Corporation. (Kim 2013.) Thus North Korea holds an up-to-date mobile infrastructure and the capacity for further expansion. Koryolink is reported to be prepared to develop e.g. wireless internet, mobile banking and payment services in the future, given the development of the business environment (Montlake 2012). Koryolink currently has over 2 million subscribers, however the actual number remains challenging to verify (Kim 2013). The increased amount of mobile phones plays an important role in the informal markets by facilitating the flow of information concerning regulations, prices and exchange rates (Lankov 2012a; Number of N. Korean mobile phone users tops 2 mln: report 2013; Kim 2013). However

international calls remain blocked and due to limited number of minutes per month included in the service fee and high price of extra minutes communication between foreigners and North Koreans remain cumbersome (Kim 2013).

Domestic sim-cards are available to foreigners as foreign sim-cards are not supported by the North Korea's telecommunication network. This can be seen as a shift towards a less restrictive policy and a modest effort to meet the needs of foreign investors. However, the domestic network operates on different platform from the foreign and thus calls between foreigners and North Koreans cannot be made (Foreigners allowed to bring cellphones into DPRK 2013). Moreover, international calls remain expensive for foreigners, but are possible (Whitehead 2013; Koryo Tours guide to mobile & internet services in the DPRK 2013). Long-term visitors and residents have reportedly been granted access to wireless mobile internet provided by KoryoLink's 3G services, even though permissions have not been stable. However, North Koreans and tourists are yet excluded from access to the mobile internet service. Wireless service is available also for the computer, however remains costly, prices ranging from 150€ to 400€ per month. (Koryo Tours guide to mobile & internet services in the DPRK 2013.)

Advertising remains prohibited by the official policy as a sign of capitalist practices. However, the regime shows signs of recognizing the need for advertising as a part of reviving the economy. Interviewee 1 (Interview 1 20.12.2013) explains that in a socialist planned economy advertising and marketing have been unnecessary. Thus the concepts are not yet well understood. However, first car commercials are visible in the country, and a few foreign ventures have been able to conduct marketing operations in North Korea in cooperation with the employees. Pyeonghwa Motors, a joint venture between South Korea's Unification Church and the North Korean government, has had large billboard advertisement of the cars for some years already and is argued to be the most visible joint venture advertising its products (Cockerell 2014). The data also signals that advertising practices of a joint venture have often been born out of necessity and as a result of learning. PyongSu Pharma, a joint venture between a Swiss pharmaceutical company and North Korean Pyongyang Pharmaceutical company, was initially denied marketing as a practice that cannot be done. However, as products could not be sold, the staff realized the importance of advertising and started preparing marketing campaigns. (Rohrlich 2013.) This signals the dual system of a socialist, formal economy and capitalist, informal economy. Among the socialist practices, capitalist practices are often born out of necessity and as a result of learning. The informal market itself can be said to be born out of the need to survive and is developing strongly as a result of learning of new business practices. Moreover, it signals that practices that are initially prohibited are possible to implement, however it is likely to remain case-specific.

## **5.1.2 Economic system**

During the course of data analysis concerning the institutional structure of the economic system, three additional categories arose that were seen as important in understanding the market structure, are were thus included in the discussion. The additional categories are presented as first (dual system, corruption, Special Economic Zones) followed by originally defined categories (capital market, product market, labour market).

### **5.1.2.1 Dual system**

The North Korean economic structure reflects a complex mixture of the formal socialist planned economy and an informal, however largely recognized market economy. The collapse of the socialist planned economy and the widespread famine in early to mid-1990s led to the birth of an illegal, informal market economy as a means of survival for the North Korean people. In the last 10-15 years the state's importance in controlling the everyday lives and activities of making a living has decreased and thus informal entrepreneurial activities have been taking a rapidly spreading foothold (Lankov 2011a). Despite several efforts to curtail private economic activities and return to a socialist planned economy, the informal economy is widely acknowledged and can be argued as institutionalized, however still lacks legal ground. This makes it prone to unpredictability without clear rules and no protection for the "entrepreneurs" (Lankov 2012a). It is presented that were the state serious about limiting the private economic activities, the informal economy could virtually not exist (Lankov 2012b). Park (2013) argues in his research that during Kim Jong Un's regime the economic system has shifted towards an "unplanned socialist economy", with the simultaneous existence of socialist planned economy and unplanned market economy, socialist regime and production system owned by the state. This differs from the former "socialist planned economy" with socialist regime, ownership and planned economy with no or little decentralization.

Cha (2012) argues in his column that the North Korean economy has three layers. The Party economy consists of enterprises and industries that generate foreign exchange reserves. The military economy consists of enterprises in the heavy industry sector, construction projects and sales of arms and aims to sustain the army with its economy. These two layers correspond with the official economy that is largely managed according to the socialist planned economy principles, and the official economy in this study refers to these two layers. These two layers are also likely to sustain the wealth of the elite. The third layer consists of the people that are not part of the party or military economy (Cha 2012) and make up the informal economy with their private economic activities. Cha (2012) suggests that the official and informal economies are separate organisms and

rarely interact with each other. Lankov (2012a) argues, however that the line between the two economic systems is strongly blurring as managers from the state-owned companies may acquire needed resources, spare parts etc. from the private markets. Factories and enterprises are also reported to lease farming land for private use in order to boost production and produce supplementary food for the employees (Seol 2014a). Thus it can be concluded that the formal and informal economy overlap, compete and interact significantly.

It is estimated that 50-75% of the income of a North Korean family is generated through private economic activities in the informal market (N.Korea's informal economy thrives 2013; Lankov 2012a; Lankov 2012b). The most common market activities are restaurants, booths, small-scale private agriculture, private tutoring and private medical services (N.Korea's informal economy thrives 2013). There is an emerging "quasi private small and medium -sized business sector" that involves numerous businesses, which are practically owned and managed privately by the emerging middle class. However, they are required to be registered under a state agency as private ownership still remains illegal. (See 2014; Lankov 2012c.) About 30-70 per cent of the profit is estimated to go to the state agency, however these entrepreneurs are able to earn income and pay their employees salary that exceeds by far the state's official salary level (Lankov 2013). Thus these ventures already contribute to the economy's survival and could contribute to an actual economic growth, however they remain strongly curtailed by the regime's fear of uncontrolled private economy and lack of property rights.

The private economic activities spread to what can be called grass root capitalism and what we now can call a growing informal economy that is institutionalized over time and is there to grow. From the viewpoint of a foreign firm this is likely to indicate that foreign investment is more encouraged compared to the past, which is also visible in the legal framework presented above. Foreign firms are still bound by the official socialist economy as forming a joint venture with a state-owned enterprise still remains the only way to establish presence in the market in practice. However, down-to-up structures for a market economy are developing and the former institutionalized structure of a planned economy is seeing modest reforms of decentralization.

### ***5.1.2.2 Corruption***

In the North Korean economic system, corruption has had a peculiar role in the survival of the people and as an enabler of the birth of the informal economy. Prior to the collapse of the socialist production and distribution system, corruption was largely nonexistent as money played little role in the economy where special rations were distributed to the officials in addition to their salary (Lankov 2012b). Thus there was little incentive in

accepting a bribe for overlooking an illegal activity. However, after the rations stopped and distribution system collapsed, the emerging private economy created opportunities for the officials to secure their living by bribery. Corruption is an undisputable hindrance for the economy's development and growth in addition to ethical and moral problems related to it. However, in the case of North Korea, we may also look at corruption from a situational point of view.

It is argued that the informal market could hardly exist, were the officials seriously acting to abolish the private economic activities. By following the official orders and prohibiting the informal economy, the officials would lose their source of income, inhibit others' sources of income or in the worst case means of survival of North Korean people. Thus activities including small-scale private farming, trading of food in the farmer's markets and long-distance travelling to transport goods across the country are tacitly overlooked even though technically illegal (Lankov 2012b). That is likely to be one of the main reasons why several attempts to abolish the informal market and return to the socialist model have failed, and Lankov (2012b) suggests that it may have saved numerous lives during the widespread famine in the 1990s.

There is little doubt that the sustainable solution would be an economic reform to legalize the informal economic activities. The informal economy is so widespread for over two decades that it can be called institutionalized and it is unlikely that the development can be stopped. However, with the regime afraid of losing its control, the informal economy can still be said to be bound to officials that are willing to overlook the entrepreneurial activities for their own gains. Even if the economic system were to function on its own in the future, corrupt practices may become a significant hindrance for the development of the market. However, from the viewpoint of understanding the North Korean market, it may be reasonable to look at corruption in relation to North Korea's peculiar past.

### ***5.1.2.3 Special Economic Zones and Economic Development Zones***

The Special Economic Zones (SEZ) and Economic Development Zones (EDZ) are currently the most promoted areas for foreign investment in North Korea and can be expected to be accessed relatively more easily than other areas and provide relatively better infrastructure and legal grounds for foreign investment. They can be seen as visible signs of the dual system and recent promotion of market-orientation: they offer relatively more market-oriented business conditions to foreign investors, however, are organized according to the socialist system and remain isolated from the rest of the country. Thus they can be seen as testing ground for more market-oriented practices all over the country

and may lead to further development and institutionalization of the market-oriented approach.

There are three active central level SEZs and thirteen provincial-level EDZs that concentrate on the development of different industries. The Kaesong Industrial Complex is run jointly with South Korea and has a joint management committee responsible for the development of the complex. The Economic Zones vary in size, focus and location. The main difference of the Special Economic Zones and Economic Development Zones is that the central-level SEZs have a broader focus in the industries that are promoted in each zone, whereas the provincial-level EDZs have a narrow focus to regional characteristics and advantages.

Special Economic Zones:

- Rajin-Sonbong (Rason)
- Sinuiju
- Hwanggumpyong and Wihwado Islands
- Kungang Tourist Zone (suspended)

Economic Development Zones:

- Aprok (Yalu) River Economic Development Zone, North Pyongan Province
- Manpo Economic Development Zone, Jagang Province
- Wiwon Industrial Development Zone, Jagang Province
- Sinpyong Tourism Development Zone, North Hwanghae Province
- Songnim Export Processing Zone, North Hwanghae Province
- Hyondong Industrial Development Zone, Gangwon Province
- Hungnam Industrial Zone, South Hamgyong Province
- Pukchong Agricultural Development Zone, South Hamgyong Province
- Chongjin Economic Development Zone, North Hamgyong Province
- Orang Agricultural Development Zone, North Hamgyong Province
- Onsong Tourism Zone, North Hamgyong Province
- Haesan Economic Development Zone, Ryanggang Province
- Wau Island Export Processing Zone in Nampo City (NK Briefs 131129, 2013)
- Kangryong Green Development Zone, South Hwanghae Province
- Umjong Science and Technology Development Zone (Babson 2013).

The Rason SEZ concentrates on high technology, international logistics, manufacturing and processing industries as well as agriculture and service sector (NK Briefs 120404, 2012; Law on Rason 2011, 1; Babson 2012). The industries promoted at Wihwado and Hwanggumpyong SEZ include light industry tourism and commerce, IT and agriculture (NK briefs 120404; Law on Hwanggumpyong and Wihwado Special Economic Zone 2011, 1; Babson 2012). The Rason SEZ is reported to be relatively well developing and functioning with around 150 joint ventures with foreign firms. Moreover, firms are reported to be able to hire employees directly despite the official system (Rajin-Sonbong a

Weird Oasis in the N.Korean Desert, 2013). Rason remains one of the most expensive regions in North Korea aside from the capital. However the other SEZs of Sinuiju and Hwanggumpyong and Wihwado Islands still remain largely underdeveloped and face challenges in attracting foreign investment. (Rajin-Sonbong a Weird Oasis in the N.Korean Desert, 2013.)

The State Economic Development Commission, previously responsible for the central-level management of the SEZ was merged under the Ministry of External Economic Affairs and thus the ministry is likely to be the current central-level organ for the SEZs (NK Briefs 140626, 2014). The regional people's committees manage the SEZs together with the central authority (Law on Rason 2011, 3; Law on Hwanggumpyong and Wihwado Special Economic Zone 2011, 3). The provincial-level EDZs focus on regionally promoted industries following the advantages of each region. It is reported that the EDZs are managed by the Economic Zone Development Bureau, however it remains unclear whether also this body has been merged under the Ministry of External Economic Affairs (NK Briefs 131129, 2013).

The economic zones are reported to offer favourable conditions to foreign investors. Preferential tax treatment includes corporate income tax of 14 % and reduction to 10% in encouraged industries in both Rason and Hwanggumpyong and Wihwado SEZs (Law on Rason 2011, 10; Law on Hwanggumpyong and Wihwado Special Economic Zone 2011, 10). Moreover, preferential tariff policies, enhanced access to communication devices, relatively more free management and setting of prices and wages are reported as relative advantages of the special economic zones in comparison to the rest of the country as an investment option (Babson 2013). The law concerning Rason has been revised several times after its introduction in 1993, providing continuous clarification of responsibilities of authorities and firms and improvements to the overall investment climate (Law on Rason 2011, Babson 2012). Even though the role and enforceability of law remains questionable in North Korea, this reflects a modest willingness to improve the business climate in order to attract investors to develop the zones.

North Korea encourages investment into infrastructure development, science and technology and production of goods for export (Law on Rason 2011, 2; Law on Hwanggumpyong and Wihwado Special Economic Zone 2011, 2). Science and technology, including software development, nanotechnology, cyber technology and security systems are areas where high level of technical education is combined with low tariffs, making North Korea a potential destination for outsourcing of e.g. IT-services with a competitive cost-quality ratio compared to e.g. China and India (Tjia 2011; Moore 2010; Williams 2010). Several IT-companies have experience of IT-related export projects including GPS services, business planning and intelligence systems, animation and mobile games (Tjia 2011; Williams 2010). Currently two Western joint ventures,

Nosotek and Hana Electronics are active in the area along with Chinese collaborations (Tjia 2011).

The economic zones can be seen as areas where more investor-friendly policies may be developed and tested in a limited space, making them currently a testing ground, however simultaneously having limited impact on the North Korean economy and society as a whole (Babson 2013, Babson 2012). This can be seen as a sign of the regime's willingness to protect the socialist system from being exposed to market economic system. Simultaneously it is likely to curtail the potential of economic development by limiting spill-over effects, integration into the rest of the North Korean economy and preventing transfer of knowledge, practices and accumulating experience to local firms (Babson 2013). In order to attract foreign investors to the economic development zones, significant increase of managerial freedom, a stronger legal framework and more opportunities to interact with the domestic economy should be granted. Thus far the economic zones may offer foreign firms an area to conduct business in a relatively more open environment with more conformity to international standards and a more advanced formal institutional framework.

#### **5.1.2.4 Capital market**

The banking system in North Korea has historically developed to serve the interest of the socialist system and planned economy in creating foreign currency instead of rotating the funds of the people in the economy. It is argued to be partly due to aid and trade with the former Soviet Union and traditionally low significance of money in the economy. Moreover, several financial institutions including banks and enterprises creating foreign exchange reserves have served the separate economies of the Party, Army and to a lesser degree, the people. Thus lack of coherence has led to a highly fragmented financial system. (Babson 2014; Cha 2012; Kim 2014.) The key financial institutions include the Central Bank, Ministry of Finance, Foreign trade bank, and some commercial banks including Jaeil Credit Bank and Koryo Bank. Banks with a foreign partner include the Daedong Credit Bank with Nice Group of China and Orabank with the Egyptian company that operates North Korea's telecommunication network (Foreign shareholding in Daedong Credit Bank sold 2011; Al-Issawi 2008; Orascom TMT SAE website 2015). The Central Bank exercises very weak control over the banking system and due to the political history and fragmentation. Thus the system has not evolved to rotate the domestic and foreign funds of the people and enterprises to support economic growth (Kim 2014). Moreover, the banking system remains curtailed by sanctions and also thus it is unlikely that it could provide foreign investors with loans or other financial instruments.

It is argued that the political willingness to develop the system exists. The Ministry of Finance and the Foreign Trade Bank seem to be speaking for the development of institutions that would steer, supervise and regulate the flow and rotation of funds. (Babson 2014; Kim 2014). Babson (2014) suggests that one important indicator for willingness to develop the financial system is whether one state institution is able to exercise more centralized power over the fragmented financial system. The cabinet has been granted growing autonomy concerning the economy and with the establishment of the ministry of External Economic Affairs under the cabinet. Therefore, weak signs indicate that the need for a more controlled and coherently managed financial system is recognized. It can be seen as a sign of acknowledging the need to regulate the duality of the informal economy and the official economy. Moreover, it can be seen that the informal economy is viewed as an institutionalized structure.

The importance of mobilizing both private savings and foreign exchange reserves of enterprises for economic growth has been recognized. However, the accumulation of wealth through the informal market stays largely in the people's hands and funds generated through the enterprises in the official economy are yet likely to be distributed according to the fragmented system (Kim 2014). Thus the government is encouraging people and enterprises to commit to circulating capital through banks and insurances. Moreover, the establishment of commercial banks has been raised in order to create structure for the flow of capital. However, the lack of trust in managing the funds and unwillingness to reveal the actual income level results in people being reluctant to deposit their money to a bank. (NK Briefs 140618, 2014.) Without circulation of funds in a reliable way and thus unable to accumulate wealth in the financial system, the banks will be unlikely to provide finance for foreign enterprises in the near future. Sanctions and unaddressed international political dilemmas, the need to create foreign exchange reserves, lack of property rights and exclusion from international financial institutions are yet problems that need to be addressed in order to create a sustainable financial system for economic growth.

Prepaid debit cards are established by two banks in North Korea, where the user can upload currency to make purchases with in e.g. department stores, hotels and restaurants in the capital. However, these cards are yet largely used by foreigners in the country (Koryo Bank unveils new debit card 2011; On the Narae debit card 2011). The interviewees 1 and 2 note a development in the capital markets introducing prepaid credit cards, as they both have been able to use such while in North Korea. Interviewee 2 notes however, that the cards may not function in the rural areas due to lack of technological infrastructure. (Interview 1 20.12.2013; Interview 2 20.2.2014). The prepaid system is argued to create revenue to the issuer via interest on the balance of the card (On the Narae debit card 2011). This signals towards creating a more modern financial infrastructure that could be expanded in the future to respond to domestic demand. Given that the North

Koreans remain reluctant to deposit their savings to a bank at full, a prepaid debit card could help in decreasing the perceived risk, however creating the issuer revenue in the form of interest and rotating the funds in a controlled system

The insurance system remains also geared towards the socialist system instead of generating economic growth. According to the data, the central bank offers insurance policies, however the main insurance institution is the Korea National Insurance Corporation. The individual and enterprise insurances offered are compulsory and the individual insurance is automatically deducted from salary and allocated to healthcare and other government-directed purposes. (Rehor & See 2012.) Thus it falls closer a healthcare tax than insurance policy. Property or life insurance is not available for individuals. Moreover, claims cannot be filed under the individual insurance. The compulsory insurance policy for enterprises includes property insurance by type of property and is available to state-owned enterprises only. (Rehor & See 2012.) However, according to the laws of Rason and Hwanggumpyong, foreign firms are also obliged to purchase insurance in North Korea (Law on Rason 2011, 10; Law on Hwanggumpyong and Wihwado Special Economic Zone 2011, 7). Prices of the insurances are determined on a basis to balance the premiums with losses and administrative costs and thus do not take into account an individual firm's risks or losses. Moreover, losses are compensated according to government-set value that is likely to differ significantly from the market value. (Rehor & See 2012.) Foreign firms may also face challenges of insuring business abroad due to sanctions and likeliness of very high premium due to perceived risk and thus a high price of the insurance. The law on SEZs permits establishment of insurance companies that may provide insurance policies for other foreign-invested firms (Law on Rason 2011, 10; Law on Hwanggumpyong and Wihwado Special Economic Zone 2011, 7). However, the overall attractiveness of the field remains questionable as more detailed calculations of risks, losses and pricing would be needed to determine profitability. Based on the data it can be stated that the insurance system is not facing major improvements to meet the needs of foreign investment. The system signals the socialist business model, where the insurance company is not expected to create revenue for growth but provides funds for the government (Rehor & See 2012). A modernized insurance system could not only create revenue for the government but also help in attracting foreign investment to boost the country's economic growth by showing willingness to protect foreign investors' interests and property.

#### **5.1.2.5 Product market**

The official production and distribution system as an institution is based on the state planning system. The system follows the socialist system and the idea of state-led

production and distribution where private ownership is not allowed. The goods produced in the factories are to be delivered through wholesale stores to administration offices under the municipal people's committee of a given area, responsible of the distribution of domestic and goods supplied by the UN. This is followed by distribution of the goods to state-owned stores where people are to collect the rations. Through which channels the distribution proceeds, the data did not include examples and thus the logistics channels remain unclear in this study. (Seol 2014a.) Moreover, the state distribution and rationing system is argued to have collapsed in the early 1990s (Lankov 2011b; Lankov 2012b). The data suggests that basic ingredients are supplied by the state, however the reliability of the system remains unclear. Moreover, the insufficient rations and nominal official salaries are largely compensated in the informal market, especially for the growing consumption of the emerging middle class (Rudiger 2013). However, the data concerning the informal market supply and distribution system is scarce and thus it can be only argued that the informal markets have such systems and they coexist and possibly interact with the official product market system.

The state distribution and rationing system can be argued to be under certain pressures for institutional change. Due to the low productiveness and lack of resources in the official economy, the production and distribution system has seen efforts to grant more autonomy to several actors in the system in order to boost production and revenues. The June 28 measures or "Economic management system in our style" can be described as the most encompassing state-led effort to decentralize the production and distribution system, which follows the shift towards an "unplanned socialist economy" (Park 2013; Haggard 2014). The effort aimed at granting increasing independence to managing and organizing the agricultural, manufacturing and enterprise sectors, including e.g. self-regulation of meeting production targets, salaries and accessing resources in the open market without state intervention. Moreover, collective farms were divided into smaller sub-units and granted larger amount of the surplus. (Park 2013.) The June 28 measures failed partly due to e.g. unease towards lessening control, resistance of elite and bureaucrats and lack of resources leading to failure in creating instant surplus (Park 2013; Haggard 2014). However, part of the measures can be said to affect the system, only in a fragmented way, depending on a given area's or facility's success in reorganizing itself. Also a new sense of competition and customer orientation has emerged in the enterprise sector as a result of the conscious efforts of increase independence in the production and distribution system. Production is organized as according to market signals for demand and preferences, and delivery services via e.g. taxis are organized for ordered goods and services (NK Briefs 140901, 2014; NK Briefs 140818, 2014). The data also reveals that the current system works interactively with the informal market practices and thus encounters pressures for change. State-owned stores may order goods from the administration office by using credit obtained from the middlemen in the informal market.

The administration offices may engage in trade and buy products from e.g. China in order to distribute those to the state-owned stores to create revenue in the domestic market. Moreover, the administration offices are argued to be required to commit a monetary sum to the production facilities in order to receive the goods for distribution to the state owned stores. (Seol 2014a.)

The above examples indicate that the production and distribution system is highly complex and has elements of both the official and informal markets. It can also be argued that the system is under change towards a less centralized direction in order to increase surplus and revenues. It remains noteworthy that a significant part of the change follows the North Korean people's activeness in absorbing and experimenting with market practices. However, part of the change is initiated by the government. The changes continue to influence the system as learning proceeds, even if the scale is likely to be smaller than expected of the June 28 measure. Interestingly the government has made the increasing competition and customer orientation a priority policy recently, reflecting the need to maintain highly capitalist practices as initiations of the socialist ideology (NK Briefs 140818, 2014).

#### **5.1.2.6 Labour market**

The education system in North Korea includes daycare system, primary school of five years, junior secondary school of three years and senior secondary school of three years (Melvin 2014). In general, children and youngsters are guided to different schools according to their talents, skills and family's political background. Interviewee 2 explains that often children apply for professional schools or to universities, depending on their talent. Political background influences the education process, and children and youngsters may be guided to different schools according to their talents. (Interview 2 20.2.2014.)

In 2012, the number of compulsory school years was increased with one year, currently being twelve years in total (Melvin 2014). Moreover, KCNA (Melvin 2014) reported that efforts had been made to enhance the curriculum with additional subjects and provide schools with more resources and staff. However, it was reported that editions to learning material shall be done according to the socialist principles of *juche*. New advanced -level secondary schools were reported to have been established in several provinces, aiming to provide easier access for talented students. The advanced schools have a reputation for guaranteeing access to university education and thus grooming students for a political career. However, with the introduction of more top-level schools, the admission to the advanced secondary school may no longer guarantee a university admission (Kim, Kim & Vandenbrink 2014.) At several top- level universities, a double-major system and new departments providing business and technology-related majors have been reported to

have been established (IFES 140327, 2014; N.Korea adopting double major system at colleges: N.Korean magazine, 2014). The current efforts to develop the education system support the notion of North Korea's growing emphasis on building a stronger economy and reflect a shift towards more international practices (N.Korea adopting double major system at colleges: N.Korean magazine, 2014). However, the developments are still expected to be strictly bound to the socialist system as the ideology is likely to be present throughout the education.

The education system is likely to suffer from several problems including lack of basic infrastructure for electricity, water supplies and heating. Moreover, the top-level secondary schools and universities still represent a path to the country's elite positions within the system, thus keeping up the political and ideological system and the managerial talents are likely to be found at top-level universities leading them to work in the official economy. Thus it would be exaggerated to view this as a sign of comprehensive reform. However, the growing autonomy and awareness of the North Korean people, growing middle class, a more up-to-date education and larger university staff mobility is likely to bring about a shift in the future towards an unplanned socialist economy with both the regime's visible efforts to boost the economy and a shift in the way of thinking of the people that is less controllable by the regime.

Despite its lacks, the education infrastructure can be argued to be relatively comprehensive and can contribute to providing foreign firms with skilled and motivated local personnel. The literacy rate is close to 100% and in addition to traditional subjects, the need to make a living and build everything from a scratch in the absence of physical infrastructure has equipped the North Koreans with vast practical skills, understanding of broad topics and the capability to learn new skills and information very quickly. (Interview 2 20.2.2014; Rohrlich 2012; Foster-Carter 2013.) Both interviewees also acknowledge the motivation to learn and skillfulness of the students as highly significant:

*Well it's the education system it has several lacks but the good things that I can directly say is that I don't think I've seen such mathematical skills almost anywhere... so it probably gives quite many possibilities...*

*They are smart people they learn quickly and they have a huge enthusiasm to learn things. And then they have the educational background, may it be a doctor, a technician or a farmer... for example if I talk about biocompostors with the academy of the university, they can give me a PowerPoint -presentation about biocompostors.*

In general, the socialist system is organized to take care of employment by selecting people to a suitable career path based on talent, family and political background.

Interviewee 1 explains that it is expected that one is assigned a job by the system and that the employment decision may be influenced, however the recruitment channels remain unclear in this study. It is estimated that that changing a job may be possible within separate ministries, however the procedure remained unknown. (Interview 1 20.12.2013.) However, the collapse of the system, social change and the existence of the informal economy have changed the pattern. It can be argued that in general, two institutionalized mechanisms of employment coexist. One can be assigned a job according to the socialist system based on e.g. education and political and family background, or engage in private economic activities due to lack of work and insufficient official salaries in several industries (Lim 2012; N.Korea's informal economy thrives 2013). The two mechanisms also interact and bribery often plays a role as an enabler to participate in private economic activities. E.g. it is reported that employees in the official economy can contribute a sum to their employer and are thus granted a permission to remain absent from their work in order to participate in the private markets, making them the "August 3<sup>rd</sup> unit" (Lankov 2012d; Lim 2012).

Trade and labour unions are organized as social organizations under the KWP and can be argued to mainly have a political agenda. Thus there is little sense in comparing the system to the labour unions in the western system that on the broad level concentrates on advancing employees' rights and interests. This difference is relevant for a foreign firm to acknowledge in order to understand the context that the North Korean markets are embedded in. The main tasks of the unions in North Korea include maintaining a social order with indoctrination, education and peer criticism as well as organizing a range of social activities covering the whole society. (Worker's Organizations 2014; Lankov 2012d.) The system can be said to be effectively institutionalized, however following the social change also the unions as institutions are under a change. They can be argued to be part of the socialist façade and history, where people participate as a habit and up-keeping of the façade. Thus the indoctrination can be argued to have partially lost its power and self- and mutual criticism session present more of a formality required by the government. As the interest of the North Korean people lies largely in making a living and earning income, absence and relaxation is tolerated when minor or possibly enabled with bribery. (Lankov 2012d.)

The compensation level and procedures for foreign-invested firms are likely to be set by the government, however there is mixed data concerning the setting of the level of the compensation. In the SEZs the compensation is to be set by the North Korean authorities responsible for the area, referring to the local people's committee and the general management committee (Law of Hwanggumpyong and Wihwado Special Economic Zone 2011, 6; Law on Rason 2011,8). However, according to the law for foreign-invested firms the compensation level is reported to be set by the firm (The complete guide to North Korea investment laws 2014). The compensation for North Korean employees in the

Kaesong Industrial Complex is reported to be about 70\$ per month and set by the state (Foster-Carter 2013; Seoul to raise salary of N.K. workers at Kaesong complex 2014). The state sector compensation level is estimated to remain between 3000 and 5000 North Korean won, one dollar being the equivalent of roughly 8000 North Korean won in the unofficial but widely effective exchange rate (Daily NK Market trends, 2016).

### 5.1.3 Synthesis

This chapter presented and discussed the findings concerning the institutional environment in North Korea. Thus it aimed to answer the first research sub-problem: *What is the institutional environment in North Korea like?* Khanna & Palepu's (2010; 2005) framework for spotting institutional voids was applied for mapping the institutional environment, and the findings are summarized in table 3.

Table 3 Institutional environment of the North Korean market

<b>Institutional environment</b>
<b>Macro context of the market</b>
Political system
<ul style="list-style-type: none"> <li>• Single party system, Kim Jong-Un as the head of the state</li> <li>• Supreme People's Assembly passing legislation and acting as an arena for bureaucratic competition</li> <li>• Cabinet is estimated to gain more independent role on economic issues</li> <li>• Political instances responsible for economic issues undergoing changes.</li> </ul>
Judicial system
<ul style="list-style-type: none"> <li>• The constitution dates back to 1948 and latest revision made in 2012</li> <li>• Three-level court system: central, provincial and people's court</li> <li>• Legislation and regulations undergoing changes. Law amendments concerning e.g. foreign investment, special economic zones and their governance, renewable energy, law on advertising and railroad transportation</li> <li>• Role of law differs significantly from the Western model; laws exercise relatively weak enforcement power whereas social networks have a high significance.</li> </ul>
Social change
<ul style="list-style-type: none"> <li>• Social change in adopting more market-directed thinking</li> <li>• Widespread self-managed entrepreneurial activities</li> <li>• Increasing role of women in business.</li> </ul>

<b>Media</b>
<ul style="list-style-type: none"> <li>• State-controlled media</li> <li>• Foreign media present in the market</li> <li>• Advertising formally prohibited, however exclusions born out of necessity within firms</li> <li>• Advertising practices under pressure of change due to growing recognition of the significance of the informal market economy.</li> </ul>
<b>Economic system</b>
<ul style="list-style-type: none"> <li>• Economic system undergoing significant changes, which makes it uncertain and turbulent to operate in</li> <li>• The market is characterized by a dual system: formal, centrally planned socialist system on the surface, however under the surface informal market economy is strongly gaining momentum and institutionalizing</li> <li>• Special Economic Zones promoted as investor-friendly business environments</li> <li>• Corruption remains a wide-spread problem, however it may have served as a means of survival in the past.</li> </ul>
<b>Capital market</b>
<ul style="list-style-type: none"> <li>• Fragmented financial market traditionally directed towards political interests</li> <li>• Recognition of the informal market in generating income has led to recognizing the need of banking system to rotate capital</li> <li>• Lack of trust results in unwillingness to commit funds to banks, hindering flow of money</li> <li>• Banking system under international sanctions</li> <li>• Some obligatory insurance for foreign and domestic firms and individuals, however filing of claims and their processing unclear. No significant improvements found in this study.</li> </ul>
<b>Product market</b>
<ul style="list-style-type: none"> <li>• The formal planned system of production and distribution through official channels severely suffering from lack of resources and low productivity, under pressure for change towards less centralization</li> <li>• The informal market economy highly significant as a compensating system to the formal planned system</li> <li>• More freedom within the formal system granted; however due to resistance the success rate of the reform remains region-specific</li> <li>• Production and distribution systems a complex mixture of the formal and informal systems</li> <li>• Sense of competition and consumer-orientation emerging.</li> </ul>

Labour market
<ul style="list-style-type: none"> <li>• Education system suffering from lack of resources, however data reveals literacy rate close to 100% and highly skilled and motivated students</li> <li>• Positions often appointed, or self-employment in the informal market</li> <li>• Labour unions' significance very different from the Western system: maintain social order and organize social activities</li> <li>• Recruiting channels unclear, foreign businesses required to employ North Korean personnel.</li> </ul>

Table 3 highlights that within the macro context of the market both the political and judicial system are encountering pressure to change, however the changes may not have direct visibility in the country's economy. The cabinet has been granted increasing freedom over management of economic issues, and law amendments have been initialized to provide basis to attract investment. However, the enforcement power of the law remains a major challenge. A pattern of social change can be seen: market-orientation, sense of competition and self-managed entrepreneurial activities take an increasing role. Moreover, women hold an increasingly important role in informal market activities.

The economic system is characterized by a dual system of the formal, socialist economy and the informal, market-oriented economy. This create uncertainty of the accepted rules of the economy. The banking system remains unable to rotate and manage capital to support economic growth. The fragmented system geared towards separate political institutions and their economic management remains the institutionalized form of the banking system thus far, although the basic political willingness exists to develop the system towards a more coherent and controlled system. The centrally planned production and distribution system is strongly overlapping with informal structures and is undergoing changes towards a less centralized direction. Literacy and education can be estimated to be advantages of North Korea. Employment is estimated to take the form of official positions or entrepreneurship in the informal market.

## 5.2 Institutional voids in North Korea

This chapter aims to discuss and describe the institutional voids in the North Korean market. Simultaneously it aims to answer the second research sub-problem: *What are the major institutional voids in the North Korean market?* The identification of major institutional voids is based on describing the existing institutional structures in the previous chapter. By exploring the existing structures of the institutional environment an identification of missing or failing institutional can follow. First the identified institutional voids on the market's contextual level are discussed, followed by discussion

concerning the institutional voids identified on the market-level. Finally, a synthesis is provided.

### **5.2.1 *Macro context of the market***

The data indicates clearly that among concrete missing or lacking structures (voids) in the institutional environment, other less concrete challenges of the macro context play a significant role in establishing and conducting business in North Korea. This is hardly unexpected, however during the mapping of the institutional environment the significance of challenges other than voids rose to a significant position and can be seen to influence businesses at least to similar degree with institutional voids. Thus from the viewpoint of the current study it is to be highlighted that the macro context where the markets are embedded in is highly important to include in the analysis in the case of North Korea. Moreover, by only addressing the concrete voids in the political, judicial and economic system the study may yield insufficient results for foreign firms as the less concrete challenges proved significant for firms to identify in order to do business in North Korea. Possibly later with a more stable and structured business environment it may be reasonable to concentrate only on the voids in the market in order to find e.g. business opportunities, however at the moment the business environment can be said to be highly important to know in addition to the voids and market structure.

Unpredictability, changes in policies and regulations, finding a balance between socialist practices and economic development and case-specific business are the main challenges identified in the current study among more concrete voids. Unpredictability is at least partly due to changes in policies and regulations, however also the lack of independent supervisory institutions is likely to affect the unpredictability of the business environment. The changing policies and regulations as well as identified changes in the political and judicial environment are likely to signal learning and trying of new practices, resulting in uneven strength and speed of change, uncertainty about accepted practices or failure of an introduced change. It has been established that the North Korean regime has the will to boost economic growth, however finding a balance between economic development and socialist ideology and practices remains a challenge that is likely to affect businesses in North Korea. In the midst of changing policies and regulations as well as developing and implementing of new practices, business is likely to remain case-specific, which increases the perceived unpredictability of the market.

### **5.2.1.1 Political system**

The political system is based on the socialist and one-party rule model and thus it remains challenging to review concretely missing structures from a different cultural and systemic viewpoint. However, the system remains structured with high degree of bureaucracy, which is likely to affect the process of establishing a joint venture, finding a partner and conducting business operations in the country. Processes of e.g. negotiating contracts and obtaining different permissions are likely to remain lengthy and cumbersome due to unclear roles and responsibilities of the central, provincial and city governments for foreigners. Moreover, lack of transparency and changes in the governing organs make it cumbersome to identify and access organs, departments and officials to cultivate relationships with when establishing a new venture, obtaining permissions and conducting operations (Babson 2013; Rank 2012). Changes in organs, such as consolidating the previously overlapping functions of the SEDC and the JVIC under the Ministry of External Affairs and shifting of power over the economy from the party to the cabinet signal an initial will to rationalize the functions and make it less cumbersome for foreign investment (NK Briefs 120229).

The data also shows cases that changes in regulations and agreements towards foreign businesses are introduced unilaterally, which gives a counter effective signal of unreliability to foreign investors. Several experts and investors agree that changes in policies and regulations are a major source of unpredictability and may deter investment into North Korea (Whitehead 2013; Investors call for more stable business environment 2013; Blanchard & Chiang 2012; Babson 2013, Rank 2012). In the case of a China-based Xiyang Group running mining operations in North Korea, North Korea is reported to have unilaterally presented revision of the contract including significant increase in salaries of the North Korean employees, water use and land lease fees and a ban on sales of the produced iron powder. Later, as the group did not respond to the revision of the contract, water and electricity were cut off and the Chinese employees were deported from North Korea without previous notice. The contract was suspended and operations halted, Xiyang group accusing North Korea of a hostile takeover and North Korea claiming Xiyang group of fulfilling only 50% of the planned investment obligations. (Mundy & Hook 2012; Lankov 2012d; Rank 2012.) Moreover, in the Kaesong Industrial Complex run jointly with South and North Korea, the operating companies received extra taxes without previous notice and solid background (NK Briefs 121025, 2012). Due to the fact that joint ventures with state-owned businesses remain virtually the only mode of entry, influence and possibility of interference of the government remain high.

Business operations in North Korea are likely to face a high degree of control and supervision from the government in order to maintain the system. The data contains an example of a Chinese-North Korean joint venture established for brewing beer, which

had to cancel its operations due to the central authority not issuing the final permission. The operations were supported by the city and provincial governments, however after waiting for the approval of the central authority, operations were cancelled and later turned into a restaurant. The North Korean staff was reported to have proposed lack of experience as the reason for not issuing the final permission. (Ruwitch 2013.) The Women in Business- program established by Choson Exchange is reported to have faced challenges in obtaining permissions for the participants to travel abroad for the overseas training period of the program. After delay and cancellation, the program received confirmation of interest in continuing the program. (See 2014.) These examples give a view of the control that the government may exercise over businesses, making it case-specific and prone to unpredictability. Moreover, it signals the cumbersome procedure to address authorities in case of issues with business operations and the bureaucratic structure and lack of transparency of the system.

#### **5.2.1.2 *Judicial system***

The legislative (SPA), executive (cabinet) and judiciary (court system) institutions remain relatively well defined on paper, however their responsibilities remain unclear for foreigners due to lack of information. Moreover, these institutions are argued to not be independent but support the rule of the party. Being part of the institutional environment, this structure cannot be identified as a concrete void, however it may pose image- or ideological challenges for foreign firms. Together with sanctions on North Korea the image- and ideological challenges may have a deterring effect on foreign firms to consider doing business in North Korea and currently few businesses announce operations in North Korea openly (Badertscher & Heim 2013). The data contains an example of North Korea having proposed Ikea to set up business in the Kaesong Industrial Complex run jointly with South Korea. Ikea turned the proposal down referring to risks related to the operations. Especially for a large multinational company, the company's image is likely to play a vast role in choosing locations for business, and even though not articulated in the data, it can be proposed that image- and ideological reasons have a part in the negative investment decision of Ikea. Moreover, a multinational firm is likely to perceive sanctions as a challenge as it may endanger relations with several other stakeholder groups (Badertscher & Heim 2013).

The main challenge within the judicial system is the weak role of the law as a governing power (Lankov 2012b; Whitehead 2013). As discussed in the previous chapter, the legal framework has been amended during Kim Jong-un's rule and initial efforts can be seen to match the legal framework with the needs of foreign investment. However, the enforcement power of the law remains weak and North Korea is known for an

unpredictable honouring of contracts (Lankov 2012b; Whitehead 2013; Hyeok 2013; Babson 2013; Interview 1 20.12.2013). The case of Xiyang Group demonstrates the weakness of the legal framework to protect foreign ventures from unilateral changes or even physical measures or an attempt to seize the operations (Lankov 2012d). The case also demonstrates that the law may be referred to in introducing unilateral changes in agreements, as the unilateral revisions of the contract were said to be backed up by the North Korean law on joint ventures (Rank 2012). The movements back and forth with encouraging business, however unexpectedly placing regulations and changes in agreements can be interpreted to reflect the government's actions of trying to balance the protectionist ideology with the need to attract investment.

From the side of a foreign business, the legal framework does not at current provide consistent and objective support for economic activities (Choson Exchange October Reason trip findings 2011). Mechanisms for dispute settlement and conflict resolution remain underdeveloped, and in practice the sides are often required to resolve conflicts through bilateral negotiations. Moreover, the legal system lacks clearly articulated property rights, and at least for North Korean citizens, private ownership remains prohibited. (N.Korea's informal economy thrives 2013.) For foreign ventures, lease of land is possible in the SEZs, however ownership of land or real estate remains uncertain as the data did not contain any examples of such activities. Interviewee 1 estimates that the state exercises ownership of land and real estate and property rights are likely to remain absent (Interview 1 20.12.2013).

### **5.2.1.3 Media**

The media remains under control of the government and thus lack of independent media can be seen as a void from a Western perspective, even though the media structure is strongly connected to the socialist system of North Korea. The amount of cell phones and tablets has increased dramatically over the past few years especially among the growing middle class in the capital, which is likely to ease the flow of information. Opening up to communication via mobile phones, internet, e-mail and skype has been slow compared to most other countries, however means of communication are more widespread than in the past (Tjia 2011). However, from the viewpoint of a foreign business venture, communication with North Koreans remains cumbersome as the foreign and local telecommunication networks are separated and telecommunication remains pricey. E-mailing remains an unreliable means of communication due to restricted internet access (See 2014; Whitehead 2013). Systematical and large-scale advertising and branding of a foreign company and its products via media remains challenging in practice, even though some joint ventures including Pyeonghwa motors and Pyongsu Pharma have been able to

conduct marketing operations in North Korea (Rohrlich 2013). It may prove challenging to find a business partner as North Korean firms lack visibility and branding in North Korea and internationally. Although firms may have websites in the North Korea intranet, they are very rarely present in the global internet. Some firms are reported to have marketing offices in China, but lack of presence elsewhere makes it challenging to identify a business partner. (Tjia 2011.) Moreover, it may be expected that the partner selection is processed via a relevant government agency rather than direct communication between two firms and information is gathered through businesses that are present in North Korea.

## **5.2.2 *Economic system***

### **5.2.2.1 *Capital market***

So far the capital market in North Korea has seen only modest development, which remains one of the major challenges to attract foreign investment and develop the country's economy (Kim 2014; Babson 2014). The informal market plays a vast and growing role in the country's economy and people's livelihood, however the capital market has not developed to facilitate growth effectively but is still rather concentrated on maintaining the socialist structures and procedures. Thus financial institutions remain insufficient to facilitate growth and management of the down-to-up -growth of the economy. (Babson 2014.) The capital is not allocated to create new capital in the formal economy, but remains scattered within the informal economy. On one hand, the capital in informal economy may be argued to create new businesses and thus slowly more capital. However, in doing so, the capital cannot be directed effectively to create and sustain economic growth on a large scale.

The macro environment with its challenges and voids affects the financial system. The financial system remains controlled by the state and thus financial institutions remain managed by officials with ties to the party. Moreover, the financial institutions lack transparency and independent supervisory institutions (Babson 2014). Changing regulations may influence the financial institutions, as experimenting with economic development is likely to continue, however simultaneously trying to maintain the socialist system. Thus the regulation towards protecting foreign investors' and shareholders' interests remains insufficient even though its importance in attracting investment is recognized.

The existing banks lack more developed mechanisms for private and enterprise savings and loans. The allocation of capital in a socialist system is likely to have proceeded

without the need of an effective banking system to rotate capital. Banks concentrate on creating foreign exchange for state purposes. (Babson 2014.) Two banks were reported to advertise their savings mechanisms, and of domestic enterprise loans the data contained one example; offices responsible for distribution of goods and government-backed commercial traders are able to obtain banks loans for expand their trading operations. The loans were reported to be interest-free, however at the time of the loan transfer, the commercial traders should transfer 20% of the loan sum to the bank manager. (Seol 2014b.) However, on a large scale savings and credit mechanisms remain insufficient both for domestic and foreign purposes. Credit is estimated to be available mostly through family and friends and conducting financial transactions remains unclear and uncertain (Choson Exchange October Rason trip findings 2011; Rohrlich 2013). Moreover, merchants are reported to prefer conducting transactions and keeping money in cash to avoid excess costs of deposit and withdrawal (Choson Exchange October Rason trip findings 2011).

A further hindrance to effectively rotating private and enterprise savings to facilitate economic growth is the lack of trust in the banking system. The amount of funds that remain held by people rather than by financial institutions is estimated to be significant. People are reluctant to deposit their funds at banks and enterprises are reported to hold capital, suspicious that the state may hinder the withdrawal of the savings and commit the capital for state purposes. (Kim 2014.) Furthermore, the overall lack of capital can be seen as a hindrance to developing financial institutions. The Rason SEZ is estimated to be one of the most promising areas to establish e.g. a foreign-based banking or insurance companies due to the relatively freer business environment and testing ground for more investor-friendly investment policies (Kim & Abrahamian 2011). Stock markets, venture capital system and other venues for raising capital remain absent in the North Korean financial market, and thus foreign firms need to rely on other venues for raising capital. Depending on the firm, industry and scope of planned operations firm equity, venture capitalists from home or international markets, own savings and loans from home or international banks may be options. However, due to riskiness and sanctions, firms may face challenges in raising capital and thus entrepreneurial operations with limited scope or joint projects of a larger multinational firm are the most likely options. The access and method of finance is however specific to a company and thus in further detail out of the scope of the current study due to the market focus.

North Korea does not publish data on the country's economy or companies' performance, and financial analysts, credit rating agencies and other producers of financial and market information remain absent on a large scale. Thus obtaining reliable information on the economy and companies van be identified as a void. The data reveals that there are a few independent companies providing expertise and information concerning business opportunities in North Korea. GPI Consultancy, based in the

Netherlands, specializes in IT-related offshore sourcing with North Korea as one of the host countries, offering strategy and transition-phase services with e.g. feasibility studies and assistance in partner selection (GPI Consultancy webpage 2014; Loughlin 2012). Phoenix Commercial Ventures Ltd, headquartered in Pyongyang, offers information concerning investment opportunities in North Korea, specializing in project finance, identifying opportunities, local partners and helping in minimizing project-related risks (Phoenix Commercial Ventures webpage 2014). These companies are a practical example of companies filling the institutional void of missing market information providers by acting as intermediaries facilitating transactions in the market.

### **5.2.2.2 Product market**

The product market in North Korea reflects the socialist system. Overall, the data concerning the organization of the product market was scarce and thus it is likely that only part of the voids could be identified. The product market is influenced by the duality of the informal and official economies, which is visible in e.g. changes in domestic policies towards encouraging freedom of production and distribution and discouraging state intervention. What could be considered a reformist effort to give more regulative grounds to the informal economy stumbled partly upon resistance towards relaxing control from the official level and lack of resources and infrastructure. However, some reforms were maintained within smaller production circles by the people. (Park 2013; Haggard 2014a; Haggard 2014b.) Moreover, state distribution agencies are reported to be able to participate in commercial activities and e.g. buy products from China through loans obtained by commercial traders from middlemen outside the state system (Seol 2014b). The duality makes the product market more prone to changes as policies aimed at more liberal production and distribution are introduced, however later again changed if found failing or threatening the socialist system. Thus the accepted practices in the market remain unclear and challenging to estimate (Park 2013). Moreover, the wide lack of regulative and legal framework and law enforcement concerning the informal market adds to the lack of transparency and coherence of the product market and its actors. The role of law and lack of clarity in dispute settlement may also add to e.g. the perceived risk of enforcing contracts with producers, suppliers or buyers.

Scarcity of information has its bearing also on the product market, as North Korea does not publish economic or market data, and accessing data from existing foreign ventures in North Korea remains limited. Researchers and followers of North Korea compile information, however are also faced with the scarcity of information. Examples of independent institutions or firms specializing in producing detailed information about North Korean firms, range and quality of their products and services and customer

preferences were not found in the data. Among GPI Consultancy and Phoenix Commercial Ventures discussed above, embassies and the European Business Association (EBA) in Pyongyang are likely to hold overall on-site information of the market and thus partly fill the existing void of providing information and services for partner selection and market evaluation (Tjia 2011). Missing intermediaries providing market information, and the North Korean firms' lacking presence on the global internet inhibits more concrete evaluation of business opportunities, assessing potential partners, goods and services as well as consumer preferences from outside the country (Ruwitch 2013; Tjia 2011; Abt 2009, 28-29). Existing foreign ventures are likely to rely on their own research and experience concerning customer preferences.

The supply and retail structure remains bureaucratic with provincial, municipal and county level agencies and offices connected through wholesalers with producers and distributing the goods to general and ordinary stores (Seol 2014b). The structure and relationship of the production and distribution network remains unclear and thus challenging for a foreign venture to utilize. Retail chains other than state-organized distribution network and untransparent informal market are few, and the data did not contain examples of logistics providers. Chinese and Russian investors have contributed to the transportation infrastructure especially in the Rason SEZ, which is likely to strengthen the possibilities of logistics (Kim & Abrahamian 2011). However, the transportation and logistics infrastructure needs more investment to meet investors' demands on a larger scale.

The data contained no practical examples of how joint ventures have established and organized their production or distribution channels. However, Pyongsu Pharma, a pharmaceutical chain joint venture between Swiss Parazelsus and North Korean Pyongyang Pharmaceutical factory, active since 2005 and connected to the ministry of health, is reported to manufacture and distribute the medical products in North Korea through a wholesale network to its pharmacy chain stores. The joint venture is reported to expand the operations and strive for larger coverage of the country. (Pyongsu Pharma webpage 2014; N.K.-Swiss joint venture to open drugstore in N.K. provincial city 2013.) Moreover, Hana Electronics, a joint venture between Phoenix Commercial Ventures and the trading department of North Korea's Ministry of culture, specialized in consumer electronics since 2003 is reported to have established a distribution network covering major cities and planning wider coverage of smaller cities (Hana Electronics opens "The Restaurant at Hana" 2014). This suggests that the companies are able to establish networks for distributing the products, however whether they rely on the official network completely, partially or have created a network for their own purposes, remains unclear in this study.

It remains further noteworthy that establishment and composition of production, supply and distribution networks are likely to remain case-specific at least to some degree,

depending on the success of finding a business partner, built relationships, political acceptance and utility of the established business (Abt 2009, 28-29; Parazelsus webpage 2014). Moreover, at the moment the most foreign ventures offering consumption goods can be said to have presence mostly in the capital, other large cities or the most developed SEZs where the emerging middle class, the North Korean elite and foreigners can afford the products and thus offer a viable customer base and growth potential. However, the customer potential in North Korea remains promising; despite growing income disparities and North Korea remaining a very poor country, the people have more opportunities to participate in the markets due to the informal economy and foreign firms offering employment (Lankov 2012a).

### **5.2.2.3 *Labour market***

The labour market functions on a different basis compared to the western model, which is relevant for a foreign company to acknowledge. On a large scale the socialist system is supposed to take care of employment, however it is largely known that North Korea suffers from lack of work and low salaries (Choson Exchange October Rason trip findings 2011; N.Korea's informal economy thrives 2013). Thus a similar labour market model as is common e.g. in Europe has not been established, although it must be noted that in this study the western model is not considered as the best or only option but as a reference that several companies can relate to when assessing the labour market structure in North Korea.

The challenge of the dual system of the official and informal economies is visible also in the labour market. For a foreign venture, the official channel of hiring employees is likely to be the only option, stating the void that foreign ventures may not be able to choose their employees themselves. Foreign firms are required to hire North Korean personnel, however managerial level and specialist staff may be selected by the foreign firm from the home country. The foreign-invested firm is appointed local staff via the labour exchange and thus it is challenging to estimate, how much influence the foreign firm may have over the recruiting process. (The complete guide to North Korea investment laws 2014; Law of Hwanggumpyong and Wihwado Special Economic Zone 2011, 6.) The data contained information however, that companies could be able to choose their employees through unofficial channels, most likely involving building relationships with middlemen and case-specific business practices. However closer information of the informal practices was not available. The data did not contain examples of a transparent employment service or agency that foreign firms could participate in when hiring employees, and thus it can be established as a void from a foreign venture's perspective. How the employees are selected and from which pool in the official system remains

unknown in this study. However, the data did not contain examples of foreign ventures stating being dissatisfied with the employees. On the contrary, data revealed that foreign ventures were often satisfied with the quality of the work and motivation as well as skills of the employees (Ruwitch 2013; Rohrlisch 2013; Tjia 2011; Abt 2009, 28).

The level of education can be argued to be one of North Korea's relative advantages. Motivation, broad level of understanding and skills as well as ability to learn quickly received acknowledgement from several companies operating in North Korea (Ruwitch 2013; Rohrlisch 2013; Tjia 2011; Abt 2009, 28). Interviewee 2 (Interview 2 20.2.2014) has noticed the broad knowledge-base of the North Koreans and argues that even if the knowledge sometimes may lack pieces, the North Koreans are well educated, have broad experiences and apply their knowledge very sharply. Organizations ranking and assessing the educational institutions remain absent, however embassies, foreign ventures with operations in North Korea and visiting staff in North Korean educational institutions are able to partly fill the void. Moreover, badges that students receive after graduating at least the prominent universities are a way to recognize a prominent university graduate (Interview 1 20.12.2013).

Technical knowledge is relatively high due to interest and promotion of the field, however specialized knowledge and long-term experience of several areas are lacking. Moreover, the level of English is likely to be low, however among the IT- personnel English is argued to be an adopted language. (Tjia 2011.) Interviewee 2 also argues that IT is a very promoted field and notes teaching of several IT-related skills and English language as lucrative possibilities for foreign firms (Interview 2 20.2.2014). Managerial talents are mostly employed by the state and the pool is likely to remain small. Thus managers and employees with special skills are often expatriates and resources are needed to educate the North Korean employees further. Possibilities of engaging the employees in training abroad are likely to remain cumbersome and case-specific, which remains a challenge if a foreign venture would plan to educate the employees in its home country in order to decrease risk of operating on the North Korean ground in the pilot phase. The Women in Business- project of the Choson Exchange faced delays and changes of schedule in the training abroad- section despite their established reputation in North Korea (See 2014).

Compensation level is likely to be set by the state, and thus foreign firms are not able to influence the compensation structure of the employees. The custom of pay for performance-based salary was not found in the data. Moreover, due to the underdevelopment of the financial system and absence of a stock market, stock-based compensation solutions are not possible. A percentage of the compensation to the employees is argued to be kept by the state, and could raise discontent among a foreign venture's stakeholders and pose image challenges.

### 5.2.3 *Synthesis*

This chapter presented and discussed the findings concerning the institutional voids in the North Korean market. The identification of the voids was based on exploring and describing the institutional environment of the North Korean market first, thus finding out existing structures and further exploring missing or failing structures. This chapter it aimed to answer the second research sub-problem: *What are the major institutional voids in the North Korean market?* The framework developed by Khanna et al. (2010; 2005) for spotting institutional voids was applied for identifying the major institutional voids, and the findings are summarized in table 4.

Table 4 Institutional voids in the North Korean market

<b>Institutional voids</b>
<b>Macro context of the market</b>
Political system
<ul style="list-style-type: none"> <li>• High level of bureaucracy resulting in inefficiency and lengthy processes</li> <li>• Lack of transparency</li> <li>• Unilateral decisions from the North Korean side</li> <li>• Possibility of government intervention, high degree of control and supervision</li> <li>• Unpredictability, changing policies and regulations, seeking a balance between socialist practices and economic development, case-specificity of business pose challenges in addition to institutional voids</li> </ul>
Judicial system
<ul style="list-style-type: none"> <li>• Weak rule of law, uncertain honouring of contracts</li> <li>• Lacking formal mechanisms of dispute settlement</li> <li>• Lacking property rights for e.g. real estate and intellectual property</li> <li>• Balancing between encouraging foreign investment and protecting the socialist system results in uncertainty and changing regulations</li> </ul>
Media
<ul style="list-style-type: none"> <li>• Media controlled by the government</li> <li>• Restricted telecommunications and internet access</li> <li>• Lacking means to communicate with North Korean citizens</li> <li>• Branding and advertising formally prohibited and knowledge and channels underdeveloped</li> <li>• Case-specificity in advertising</li> </ul>
<b>Economic system</b>

Capital market
<ul style="list-style-type: none"> <li>• Lack of transparency</li> <li>• Lack of supervising organs such as an independent Central Bank</li> <li>• Lack of commercial banks and unclear responsibilities of banks</li> <li>• Lack of structure for facilitating growth and capital flow</li> <li>• Lack of structure for savings and loans</li> <li>• Lack of stock markets or venture capital system</li> <li>• Lack of trust in the banking system</li> <li>• Lack of institutions providing financial information</li> <li>• Lack of effective insurance policies</li> <li>• Significance of personal networks</li> </ul>
Product market
<ul style="list-style-type: none"> <li>• Intertwined formal and informal systems</li> <li>• Case-specific distribution and logistics channels</li> <li>• Lack of information of production, distribution or logistics providers</li> <li>• Lacking legal framework and law enforcement</li> <li>• Significance of personal networks</li> </ul>
Labour market
<ul style="list-style-type: none"> <li>• Lack of freedom of recruiting personnel</li> <li>• Lack and unclarity of recruiting channels</li> <li>• Lack of specialized knowledge</li> <li>• Limited pool of managerial talents</li> <li>• Limited ability to influence compensation</li> <li>• Case-specificity and reliance on personal networks in recruiting</li> </ul>

Table 4 points out some of the major voids in the North Korean market. Within the macro context, bureaucracy and lack of transparency of the political system can be identified as voids in addition to unpredictability and case-specificity. The enforcement power of the law remains weak, and mechanisms to protect investors' interests are lacking in several areas. Communication media with the North Koreans remain limited.

Within the economic system, the lack of financial structures to effectively rotate capital for economic growth can be identified as a major institutional void for investors. Lack of institutions for savings and loans and overall lack of trust in the banking system remain voids that curtail the country's economy. Production and distribution systems lack clear channels and intermediaries for market information. Labour market lacks clear channels of recruitment and a foreign company's influence in the recruitment decisions remain limited. Lack of specialized knowledge and availability of managerial talents in some fields can be identified as a void.

### 5.3 Possibilities to overcome institutional voids in the North Korean market

This chapter aims to discuss the possibilities to overcome institutional voids identified in the North Korean market. Simultaneously it aims to answer the third research sub-problem: *What possibilities do foreign firms have to overcome institutional voids?* Possibilities arising from previous literature are discussed in the light of findings from the data and reflected to the findings concerning the North Korean market structure and its voids. Finally, a synthesis is provided.

#### 5.3.1 Significance of legitimacy

In this study, legitimacy refers to conforming to formal rules and informal customs of a country in order for a firm to enhance its prospects of survival and gain access to several resources (Meyer & Rowan 1977, 340; Farashahi & Hafsi 2009, 643). It is argued in this study that in order to be able to do business in North Korea, firms need to conform to several formal rules, laws and regulations in order to successfully conduct business operations in the country. In order to enter the country, firms need to conform to the formal institutional environment by using a legitimate strategy to enter. A concrete example is the law concerning permissible entry strategies, at the moment only allowing entry by joint venture, which also both interviewees agree upon. (Interview 1 20.12.2013; Interview 2 20.2.2014; The complete guide to North Korea investment laws 2014; Law of Hwanggumpyong and Wihwado Special Economic Zone 2011, 1; Thompson 2011, 42.) Moreover, firms are confronted with a variety of regulations concerning e.g. taxation, recruiting, forming contracts, advertising... As the ruling political party and the state continue to exercise strong influence over the economic environment in the country, Tan and Litschert's (1994, 3) argument concerning conforming to the dominant power can be argued have significance in North Korea; often it is the only way to develop business in the country. Interviewees 1 and 2 express the opinion that conforming to the rules and regulations of the market play a significant role in getting business started successfully:

*One is kind of not able to enter the market if it's not politically and socially accepted – – that it's like politically accepted so it doesn't offend politically and should concentrate on the product – – (Interview 1 20.12.2013)*

*It has great significance because it is the only possibility – – there's not much use criticizing it because it will only undermine the slightest chances that exist – – (Interview 2 20.2.2014)*

Gaining legitimacy can be seen as a prerequisite to gain social acceptance of the dominant powers of the country and so pave way to strengthening business possibilities in North Korea as presented in the theoretical framework (Gelbuda et al. 2008, 4). Moreover, in the case of business ideas or practices that are perceived as threatening by the government, the business may face unexpected challenges that can lead to failure of the business plan. One of the challenges is that investors are in many cases unable to identify the reasons of ambiguity of the North Korean authorities. The Women in Business- program of Choson Exchange, active in the field of education in North Korea since 2007, offers an example and insights to overcoming abrupt changes of regulations. The program faced sudden and unexplained challenges with participants' travel permits, which could not be issued as promised. However, negotiations and careful adaptation to the changed rules ensured the continuation of the program and travel permits were issued later. (See 2014.) Successful negotiations with relevant authorities concerning the usefulness of the program can be viewed as a result of conforming to the political and social rules over time in such a way that the program was not seen as harmful, but on the contrary, necessary for the country's development. Businesses that have established social acceptance and gained legitimacy through political acceptance may also have more leeway when negotiating about further businesses or solutions to a challenge.

As the institutions to find information about markets, possible business partners or distribution possibilities, access to human capital or purchase raw materials remain underdeveloped and in fact very unique to the country, gaining social acceptance through conformity can be a crucial factor to gain access to information and networks. Thus it can be argued that legitimacy can help to enhance access to information and networks, which may help overcome several voids in the institutional environment.

### **5.3.2 *Building networks and relationships***

Doing business with a partner and establishing a network with relevant actors and authorities are highlighted as perhaps the most important steps when doing business in North Korea (Abt 2009, 28; Tjia 2011). In general, the data of this study suggests that building and nurturing networks on several levels is the underlying key to overcoming many institutional voids and do business in North Korea. Despite some efforts and recognition to establish market-supporting institutions to attract business to North Korea, institutional structures to support business are still very weak and under change. Thus networks and relationships are a crucial part in compensating for many lacking institutions (Peng & Heath 1996, 505).

The whole dual market system in North Korea provides a concrete example of the significance of informal networks in the country. In the absence of market-supporting institutions, a “market-system” relying mostly, if not solely, on networks, has been born out of necessity to survive. The informal market still remains illegal and thus without institutionalized, formal arrangements to support its functioning and growth. Thus networks and personal relationships come strongly into play, and it can be argued that the great majority of the informal market functions based on the networks between people. E.g. supply and distribution chains rely on informal networks and credit is argued to be mostly available through family networks. (Choson Exchange October Rason trip findings 2011; Rohrllich 2013.) Thus the degree of institutional underdevelopment and uncertainty call for a strong network and a reliable business partner(s), highlighting the importance that networks have on business. Simultaneously it is yet another support for the finding that informal networks substitute for lacking institutional structures.

Two major reasons for the importance of networks and relationships can be established. First, family ties, personal relationships and networks within and between firms are a central part of the Asian business culture. Referable to *guanxi* in China or *blat* in Russia, building and nurturing trust in relationships is a significant cultural part of the business culture in North Korea. Interviewees 1 and 2, having visited North Korea several times during their projects, stress the importance of building trust in the relationships in order to slowly secure ground for mutual business:

*If you have a reference or someone you know, that's always better. - - but face-to-face, that's how one has conversations with the North Koreans. If you even give a hint that you are in a hurry, well, sorry to say... they are not in a hurry. - - You build it, and it's very fragile, the building phase. (Interview 2 20.2.2014)*

However, Interviewee 1 notes the controversiality that also some businesses might start successful operations without significant connections.

*Without networks there's nothing so a person's value is kind of measured there, with the networks - - there's also "kin" and when we talk about Confucian societies the family is the most important thing also in business... and it is used in a way you scratch my back and I'll scratch yours... but then again also it's an interesting example if you take the jeans example from Sweden. Those guys didn't know anyone. And still they managed to get jeans out of the country. (Interview 1 20.12.2013)*

Second, studies show that informal networks act as substitutes for formal institutions in institutionally underdeveloped markets (Peng & Heath 1996, 505; Luo & Chung 2013,

591; Peng 2003; 276; Miller, Lee, Chang & Le Breton-Miller 2009, 802-803; Tracey & Phillips 2011, 24). Foreign firms are confronted with challenges when seeking to operate through market-supporting institutions, since they might be lacking or underdeveloped and undergoing changes. Needed resources or information may not be found or accessed through market-supporting institutions, thus increasing the significance of networks and personal ties as substitutes for the formal institutions. The intra- and inter-firm networks and personal relationships with e.g. employees, managers and government authorities provide a certain structure within which accessing resources and exchange of information takes place in an uncertain market such as North Korea. Understanding the structure of how to build and maintain these networks is one of the core elements to start bridging the institutional voids that a foreign firm is likely to encounter. However, a firm with an established reputation, functioning network and successful business in North Korea may face less challenges concerning its business and is likely to have more leeway in negotiating satisfactory solutions for the business. The foreign businesses with solid and extensive may influence authorities to pave a more favourable business environment for the firm. PyongSu Pharma provides an example of this: the challenge of marketing was solved as the employees recognized the need for it in order to sell the products. Thus networks of the firm were used to negotiate the possibility for advertising campaigns (Rohrlich 2013).

However, for a foreign business, the question is, how to gain access to the necessary networks? In the case of a foreign company, the route to conducting business generally proceeds through formal channels first, however networks and relationships play a crucial role also in the official channels (Interview 2 20.2.2014). Foreign businesses are naturally excluded from kinship and family ties, and more significance is put on the intra- and interfirm networks and relationships with several authorities. Moreover, networks between other foreign businesses may prove highly helpful in bridging the institutional voids, as information and contacts may be shared. Gaining legitimacy and political acceptance for the business, identified as important first steps, can be argued to proceed through informal relationships with relevant authorities. Interviewee 2 explains the importance of meeting the relevant authorities and building relationships in order to strengthen the acceptance of the business. He also describes the need to take into account hierarchical steps when commencing with building business relationships.

*If one wishes to do business in North Korea, the formal way is the only way. – – and if I should want to introduce a new pesticide – – then the highest person in the academy who knows about the subject, speaks English and understands our way of thinking and their way of thinking, that's the channel through which to sell the idea. – – so I always should take my Finnish superior, or his/her superior, as the highest leading organ meets the equivalent category of leaders, the second*

*category their equivalent category and so on. They need not necessarily be experts on the subject, but that's the way things proceed.* (Interview 2 20.2.2014)

Gathering information and extending networks by contacting e.g. embassies, the European Business Association in North Korea and existing foreign businesses in North Korea may provide helpful assistance. However, the data suggests that visiting North Korea in e.g. trade fairs is one of the most effective tools to decrease the institutional distance, gather information and map potential partners (Investors call for more stable business environment 2013). Interviewee 2 highlights the significance of visits he has conducted to North Korea in order to slowly build trust within the network for commencing a project. Moreover, he mentions the usefulness of inviting the involved North Korean authorities into Finland on a later phase in order to deepen the understanding of the project and simultaneously strengthen the business relationship. (Interview 2 20.2.2014.)

### **5.3.3 Cooperating with a local partner**

The data suggests that finding a suitable North Korean partner is an essential step in doing business in the country as it is likely to influence the joint venture's performance drastically (Abt 2009, 28; Tjia 2011). All the business ventures that the data includes involved a North Korean business partner, reinforcing that a joint venture is the encouraged or the only way to do business in North Korea at the moment. Naturally a partnership presents the firm with the challenge of not having complete control over the business and having to balance between two firms' interests, strategies and cultures. However, considering the present market conditions in North Korea, it can be argued that independent control over the business is a challenge as such to obtain. Therefore a North Korean business partner may provide a reasonable option to enhance the possibilities to do business in the market. In the previous chapter it has been established that it is crucial for a foreign business to create its own network and cultivate personal relationships and a business partner may provide access to further networks, once a reliable and suitable partner has been found.

However, the task of finding a suitable partner is influenced by several voids, the largest of which being the lack of information about potential partners and lack of transparency of the target industry or field of business. Interviewee 1 notes that once a suitable business partner has been found, business can start to proceed. However, finding a partner may be a challenging process, although interviewee 1 notes that North Korea may be actively looking for foreign partners in certain fields despite the lack of available information to the foreign companies. (Interview 1 20.12.2013.) Networks and relationships to e.g. expatriates, consultants or existing foreign businesses may be of significant help when seeking potential partners and getting introduced to them. Thus the

usefulness of networks as an underlying condition in order to overcome voids that a foreign business may encounter.

Abt (2009, 28) notes that foreign businesses may be introduced to a potential partner by a firm manager or authority following a vested interest. Therefore, he points out that it may be useful to find several potential partners and conduct trial periods of business with several potential companies to sort out the most suitable partner. Also smaller-scale pilot projects may come into question in verifying the suitability of potential business partners (Tjia 2011). Abt (2009, 28) presents two examples of joint ventures he has been founding. In the case of Nosotek JV the foreign partner was first introduced to only one North Korean firm, which was stated to be by far the best. Despite, Nosotek conducted trial period of a year with three selected firms and found a suitable partner, leaving out the one recommended to them first. In the case of PyongSu Pharma, a consultant with a foreign background introduced the founders to a partner that turned out to be suitable. However later a firm came to their recognition that would have had more resources and a readily built retail network, of which the consultant had not been aware. It can thus be stated that the voids of lack of information and transparency in partner selection may be eased with networks and trial periods with several potential partners before forming a joint venture.

Entering into an already existing joint venture as a third investor can help the foreign firm get started with business in North Korea with relatively lower risks and costs, simultaneously overcoming the void of obtaining information concerning the North Korean market. Interviewee 1 argues that it may be possible, however rather unusual. Moreover, the reaction of the state remains unknown:

*Well if you think of cooperation with the Egyptian telecommunications operator, let's say that you'd like to enter the market - - I believe they could be of help, yes. And then there's the point if the North Korean state interferes if a firm is operating there and an outsider enters like hey, we are also entering this business... so how the state would react to that. And I believe it's still a long way to that. (Interview 1 20.12.2013)*

If having a chance to enter an already existing joint venture, the firm can be said to spare the risks and costs of selecting a North Korean partner. Naturally there are risks and costs associated with the selection of an existing business in North Korea, however information may be more easily available of a joint venture with e.g. Chinese or European partner and the North Korean partner selection has already been made. Thus the third firm may start business in a smaller scale, offering the existing joint venture e.g. a product or service helping the firm develop or generating a competitive advantage. Moreover, by gaining access to existing formal and informal networks the evaluation of business opportunities,

potential partners, goods and services as well as consumer preferences is easier than from outside the country. Thus the firm can gather market experience and information and build its own networks within the country. The existing joint venture may have available financing options, channels for accessing resources, materials and distribution systems, which the firm may gain access to and participate in or learn from for the future.

#### **5.3.4 *Partnerships with conglomerates and business groups***

Khanna and Palepu (2000, 269) argue that business groups can alleviate institutional voids in all the three market dimensions presented earlier: capital, labour and product markets. That is due to their ability to pool and use resources of affiliated companies and departments. Thus they may internally perform functions that are lacking in a developing country and in that way fill institutional voids. In this study it was argued that business groups and conglomerates perform better in emerging markets than standalone firms due to their extensive networks and affiliations that provide for resources otherwise challenging to obtain due to institutional voids. Moreover, business groups and conglomerates enjoy a strong reputation and long-term commitment within the business group but also with external partners, suppliers and other stakeholders. (Chang & Choi 1988, 147-148; Khanna & Palepu 2000, 269; Khanna & Rivkin 2001, 49; Miller et al 2009, 803-804.)

However, the data collected for this study did not contain examples of foreign businesses cooperating with conglomerates or business groups in North Korea. There may be several reasons for that; large business groups may not find the North Korean market attractive or financially viable despite the growing middle class and uncontrolled, yet ongoing marketization. Moreover, business groups may find the uncertainty too large or may be cautious about image-related factors. The lack of data does not automatically mean such co-operations to not exist, however they may still be rare and information may be challenging to obtain. Cooperating e.g. as a triangle with a North Korean partner and a business group may be a possibility for a foreign company in the future based on the data that North Korea currently encourages joint ventures as entry modes. However, it can be estimated to not be very likely in the near future. Thus this chapter remains on a more theoretical level regarding how partnering with business groups and conglomerates may help a foreign firm tackle some of the voids in the North Korean market.

For foreign firms seeking to overcome institutional voids specific to the North Korean market, the advantages of business groups would arise from their knowledge of overcoming institutional voids in relatively similar cultural contexts, their extensive inter- and intra-connected networks and from the ability to fill institutional voids due to their diversification (Chang & Choi 1988, 142-143; Khanna & Palepu 2000, 268-269). North Korea lies geographically surrounded by economies that have a long tradition of

organizing business as business groups and conglomerates that have experience of overcoming institutional shortcomings in their own market. Thus in the North Korean market, cooperating with conglomerates or large business groups from the neighbouring countries of China, Japan and South Korea may be an opportunity for a foreign company to gather information through the groups' networks, as business groups have established channels of sharing information. Thus it is filling the void of gathering information on how to operate in institutionally weak or unstable markets. Moreover, the networks that business groups have to their internal and external partners, stakeholders, employees and other interest groups can reduce costs of transaction, provide access to resources and bridge institutional voids in the market's context and in the economic system.

Diversification strategies and structures of business groups and conglomerates naturally differ greatly across and within markets, however research shows that forming of business groups is largely a response to reduce transaction costs that arise from market failure caused by institutional voids (Chang & Choi 1988; 143; Khanna & Palepu 2000, 279). A business group, which is diversified vertically to related or supporting industries, may provide a partnering company with a possibility to access e.g. raw materials and supply options as a result of pooling the resources of various businesses and wide network of different actors. Thus it may help bridging the void of lacking information and availability concerning production, distribution or logistics providers. On the other hand, horizontal diversification of a business group into unrelated industries may provide its foreign partner access to internal capital and other services. Aoki (1990, 14-16) illustrates the strongly interconnected ownership structure of business groups and banks in Japan and Chang and Choi (1988, 147) explain that South Korean *chaebols* have traditionally been able to pool and allocate business groups' capital to affiliated companies, creating structures that function as substitutes for the lacking intermediaries in the capital market. A partnership with a business group may thus provide a possibility to alleviate the void of underdeveloped capital market in North Korea and provide a foreign firm with an alternative channel to access the groups' internal capital. Khanna and Palepu (2000, 270) argue a business groups' internal capital to may be less costly than external capital on underdeveloped markets. Moreover, external capital providers may be hesitant to finance business operations in North Korea, as the financial and legal institutions protecting creditors' and investors' rights remain poor.

Chang and Choi (1988, 147) provide an example of Hyundai, a South Korean conglomerate, that has organized a "General trading company" as providing the import and export operations of the business group. It is an example of possible business functions that business groups have internalized in order to fill missing institutions of their own market. Moreover, given an established cooperation with a business group and a North Korean partner, it may provide a foreign business a possible import and export channel. Finally, in order to alleviate missing legal institutions that would facilitate and

regulate e.g. disputes, contract enforcement and property rights, business groups are argued to have created a system of building a strong reputation in the market and honouring of contracts with its partners (Khanna & Rivkin 2001, 49). Therefore a partnership with a business group may provide a more stable system of a legal framework for trade and law enforcement compared to the North Korean market. Moreover, an established reputation may help in gaining social acceptance in the North Korean market and help the business operations to gain legitimacy as discussed above.

### **5.3.5 *Filling institutional voids with institutional entrepreneurship***

Thus far, institutional voids have been seen as hindrances to market functioning and development in this study (Khanna & Palepu; Mair & Marti 2009, 421-422; Mair et al. 2007, 35). Instead of perceiving institutional voids only as hindrances that need to be overcome, they can also be seen as spaces of opportunity (Mair et al. 2009, 35; Tracey & Phillips 2011, 24).

Previous literature suggested that governments or business groups may perform functions that healthy institutions provide to support the functioning of a market. However, if the market does not offer viable financial potential, business groups may stay away. Thus it remains the institutional or social entrepreneurs that may fill the voids by establishing a business. (Mair & Marti 2006, 37, 39; Mair & Marti 2009, 422; Khanna & Palepu 2000, 269; Khanna & Rivkin 2001, 49.) Based on the data of this study, the fact that larger business groups and conglomerates from e.g. China, South Korea and Japan remain absent may lead to the conclusion that business groups and conglomerates do not at present view the North Korean market as attractive enough to enter the market and use their resources to create value by filling institutional voids. It may be possible that some smaller Chinese business groups are present in the market, however, the data did not contain example of those and thus the suggestion is not backed by the data. On the other hand, data contained a few examples of businesses that have been able to solve challenges caused by missing institutions by establishing business operations to fill a void. Thus the data suggests similarly as previous literature that it remains the smaller, more entrepreneurial and possibly social businesses that are currently willing to harvest the potential of the market by filling the institutional voids in the North Korean market.

Two main ways of filling institutional voids can be distinguished based on the data collected for this study. First, institutional voids may be filled and thus overcome out of necessity. That often happens in the midst of a functioning business venture, when a structure crucial to the venture is absent or weak. Some existing businesses in North Korea provide examples of recognizing the need of a new structure and filling the void themselves: Orascom, the foreign partner of the joint venture Koryolink, has announced

to have established a customer service center, launched marketing activities on TV and radio channels and an advertising billboard despite lacking institutions to support these business expansions. It also has established a banking subsidiary, Orabank, in North Korea, which has been established to ease the processing of subscriber payments in the country, where banking and payment institutions still remain underdeveloped. (Al-Issawi 2008; Orascom TMT SAE website 2015.) At current, however, Orascom is facing competition from a new entrant and challenges concerning the valuation of its assets e.g. due to lacking institutional framework of valuing the North Korean currency despite its commitment, reputation and networks (Williams 2015). Moreover, Hana Electronics, specialized in consumer electronics since 2003, is reported to have established a distribution network covering major cities and planning wider coverage of smaller cities (Hana Electronics opens “The Restaurant at Hana” 2014).

These companies have most likely done what was presented as bricolage, in other words, “making do” (Baker & Nelson 2005, 333) of the resources at hand in the challenging market and combining them in creative ways to overcome the limitations of the market (Mair & Marti 2009, 423; Mair et al. 2007, 39; Phillips & Tracey 2007, 316-317). Most likely the long presence in the market and social acceptance have helped to gain legitimacy for the filling of a void. Moreover, active building of networks has helped both companies to expand their operations. Moreover, both companies are formed as a joint venture with a North Korean partner, which may have helped them to access the networks and needed resources. These skills and preconditions seem to positively correspond with the set of skills presented in the theoretical review.

Second, filling a void can be the core idea of the business, in which case the void is filled deliberately, referred to as institutional entrepreneurship (Tracey & Phillips 2011, 29). Alongside with having established a supply chain, PyongSu Pharma’s initial business idea is an example of establishing a business that directly fills a void. The company offers complementary medication that the free, yet poor and insufficient healthcare system and hospitals do not have available. Even if having the drawback of not being available to every North Korean, the products complement the healthcare system and may bring spillover effects in learning of manufacturing certified pharmaceuticals (Abt 2009, 28). The joint venture Koryolink has established North Korea’s first 3G telecommunication network and brought mobile phones to two-three million North Koreans (Williams 2015; Kim 2013). Even if the communication system does not reach but a fraction of the North Koreans thus far, the business idea has significantly improved the institutional gap of missing communications structure by bringing up-to-date technology to the country. Thus the country spares the effort and cost of going through several development stages of communication, starting from outdated technology and slowly updating it to more advanced technologies. Koryolink provides an example of how filling a void as significant as lacking communications infrastructure can develop the institutional

structure of a market by introducing and institutionalizing new legitimate practices (Tracey & Phillips 2011, 24). These examples showcase that institutional voids may be turned into opportunities, however they are likely to have taken significant amount of time, negotiations, active development and use of networks.

Institutional entrepreneurship can also take the form of social entrepreneurship, where creating social value or spurring social change is seen as the main goal instead of creating immediate financial value (Mair & Marti 2006, 37, 39; Mair & Marti 2009, 422). Based on the data of this study it can be argued that social entrepreneurs may find opportunities to fill voids and help the North Korean market to develop and institutionalize its market structure. Choson Exchange provides an example of a social entrepreneurship in North Korea: it is a voluntary work -based NGO that focuses on offering training in entrepreneurship and enhancing business skills in the form of workshops and overseas training. (Weisensee & See 2014, 2-4.) As argued earlier in this study, Weisensee and See (2014, 2-4) continue to argue that especially women are the engines of economic development and social change by establishing smaller and medium-sized, more and less formal businesses, which has become one of the major ways to secure income as the formal economy fails to provide jobs and basic income. Moreover, young people grow up in a North Korea that has a complexly intertwined formal and an informal economy and the need to secure one's own income, often with entrepreneurial activities. Choson Exchange's training programs thus target young entrepreneurial talents and female entrepreneurs and managers (Weisensee & See 2014, 2-4). Choson Exchange provides an example to see the pattern explained above: lacking or failing institutions are not covered and regulated by the government, neither are the business groups filling them, possibly due to lack of financial attractiveness of the North Korean market. Thus social entrepreneurial activities have a highly significant value in filling institutional voids and simultaneously facilitating social development and slowly spurring social change.

Institutional and social entrepreneurship can spur political resistance from the governmental sector, as it may challenge or change existing structures and facilitate change in social status quo (Mair & Marti 2009, 433). Choson Exchange reports to have encountered resistance at least concerning participants' and especially women's permits to travel abroad for overseas training. Moreover, program that focuses mostly on female business talents encountered resistance in a patriarchal and hierarchical culture (Weisensee & See 2014, 5). That provides an example to understand, how informal institutions of the market's context such as traditions and culture as well as formal institutions such as the governmental sector can affect a firm's business activities. The resistance may endanger the venture's legitimacy and political acceptance, and also in the case of Choson Exchange's programs, significant amount of cultural understanding, time to develop relationships and adaptation to changing regulations has been required. Weisensee and See (2014, 6, 8) enlighten that Choson Exchange also has local partners

that it works with, majorly with two contacts, which underlines the importance of a local partner as a means to overcome challenges set by the institutional environment. Despite the institutional and social change that the programs slowly introduce, Choson Exchange has been able to renegotiate their local partners and introduce programs that deviate from the traditional patriarchal social norms. Moreover, North Korea has shown continuing interest in the programs also during times of political changes. Thus it is evident how maintaining political acceptance, creating positive reputation, taking time to develop networks and using them among other factors can facilitate the survival of a foreign business venture, may it be seeking social or financial value, or both.

### 5.3.6 *Synthesis*

This chapter presented and discussed the findings concerning possibilities to overcome institutional voids in the North Korean market. Thus it aimed to answer the third research sub-problem: *What possibilities do foreign firms have to overcome the institutional voids?* The findings were reflected on the previous results concerning the identified institutional voids in the North Korean market.

The findings from the data supported the possibilities presented by previous research in all but one case. Gaining legitimacy and social acceptance, building of networks, cooperation with a local partner and filling institutional voids were seen as significant ways to respond to the voids or smoothen the way to build business operations in North Korea. Especially legitimacy, networks with governmental actors, authorities and other businesses and cooperating with a North Korean partner were highlighted as important in substituting for formal institutions. Thus the notion that in the absence of a strong, formal institutional environment individuals and businesses tend to rely on trust within informal networks can be strongly backed up in this study (Peng & Heath 1996, 505; Luo & Chung 2013, 591; Peng 2003; 276; Miller et al. 2009, 802-803; Tracey & Phillips 2011, 24). However, in the case of the North Korean market the data did not present support for partnerships with business groups or conglomerates, leaving it out of the possibilities to overcome institutional voids in North Korea at present. In the future however, it may be a viable option; backed by previous literature, partnerships with large business groups could offer a foreign firm several advantages in imitating the functions that developed market-supporting institutions perform (Chang & Choi 1988, 147-148; Khanna & Rivkin 2001, 49). However, business groups are likely to seek clear financial incentives in order to establish presence in North Korea.

Establishing a business to target a specific institutional void remains an effective possibility to overcome voids in the North Korean market, simultaneously accelerating the development of the market and creating competitive edge. Examples of both

financially and socially driven businesses exist, established originally to address a void or in a later phase of business to tackle a challenge. Despite the emerging middle class in the largest cities and the ongoing social change the immediate financial gains may remain uncertain thus far. However, the market can be said to offer significant opportunities for socially-driven businesses that seek to improve the institutional environment and spur overall social change in the country, creating financial gains over the longer term.

The presented possibilities to overcome institutional voids may also be presented as a hierarchy: each step can be seen as a prerequisite for the next. The development of business ventures in North Korea are likely to follow highly different paths, however, similar steps were identified to be taken by the example companies in this study. The order identified in this study is presented in figure 5.

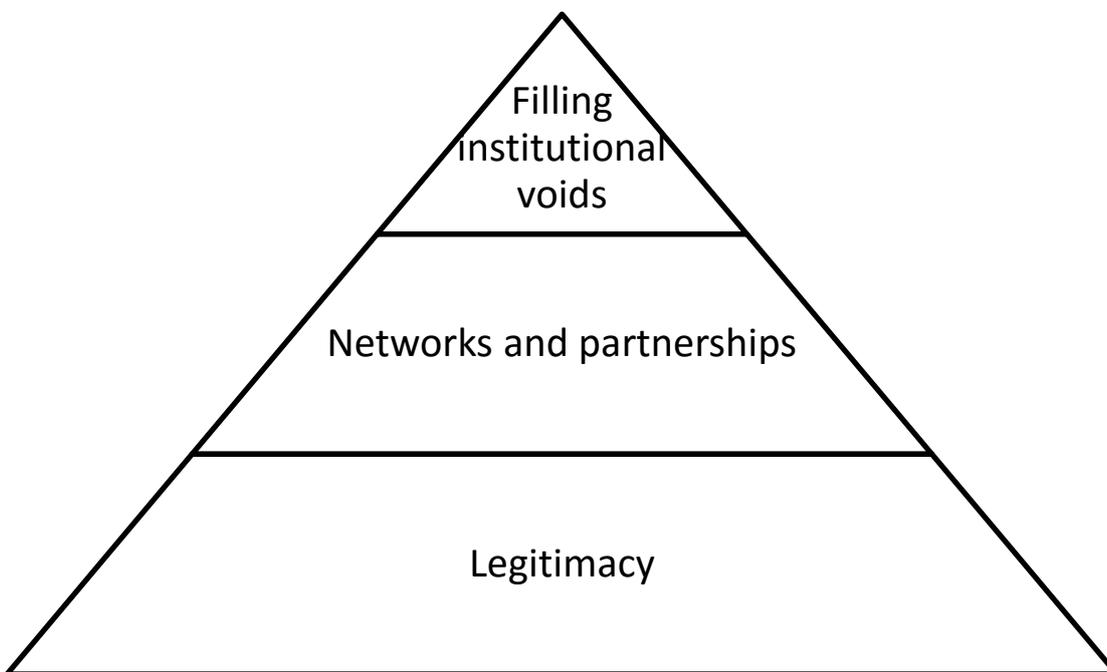


Figure 5 Hierarchy of possibilities to overcome institutional voids

The figure illustrates the finding that legitimacy as a way to secure socio-political acceptance is a prerequisite for successful entry and presence in the market. It can also be seen as a prerequisite for starting to build networks and relationships in the market. Through building and nurturing of networks and relationships, business partners can be sought through either official or informal channels. Through business partners also networks and relationships can be widened and nurtured. Thus networks and partnerships are presented as an entity, as they are likely to influence one another. After presence and solid networks with partners have been established, foreign ventures may have more leverage and negotiation power to establish businesses and practices that solve institutional problems or respond to institutional voids. Simultaneously foreign ventures may be able to develop the market structures further.

The illustration remains rather superficial, and it remains clear that the presented possibilities cannot overcome all institutional voids in the market. Moreover, businesses may take very differing paths to establish presence and overcome voids in the North Korean market, let alone in different emerging and developing markets. However, the purpose of the study was to explore possibilities to overcome institutional voids, and the presented illustration hopes to give material for further creation of hypotheses and theories in the future.

## 6 SUMMARY AND CONCLUSIONS

### 6.1 Summary

The purpose of the research was to present a current, holistic view of the North Korean business environment and to study, how foreign companies can overcome the institutional voids in the North Korean market. The author saw a need to conduct a realistic study that would neither “demonize” the country nor would paint an unrealistically hopeful picture. Based on the results of this study, the answer to the research question “*How can foreign companies overcome institutional voids in the North Korean market?*” can be summarized as follows. As a first step, a thorough familiarization to the market’s institutional framework allows to map how the market functions – and which structures do not function. To gain a broad understanding of the market, the mapping should include both the market’s contextual structures such as political, judicial and socio-cultural structures, as well as market-level structures e.g. the capital, product and labour markets. Second, based on the understanding of the market’s structural and cultural factors the most significant institutional voids or other challenging factors can be uncovered. Moreover, market-specific possibilities to overcome the most significant voids can be drawn. The possibilities may then be reflected to the strategy and goals of the firm to tailor a firm-specific strategy for business in the North Korean market. The same steps may be broadened to familiarization and assessment of other markets as well.

The institutional environment in North Korea is strongly characterized by two systems; the formal socialist system kept up by the state and the informal, however tacitly recognized and institutionalizing capitalist market driven by the people. The systems overlap on both formal and informal domains and compete, causing a complex business environment that shows the formal socialist picture to the outside, but reveals the informal market’s power as one scratches the surface. It can be concluded that the North Korean market is seeing changes in both the market’s contextual institutions as well as on the market-level institutions. In addition to simple underdevelopment and lack of institutions, institutional voids in North Korea can be seen as a result of experimenting, failing and learning with new institutional structures. The leadership of the country can be argued to a certain degree see the need to change the business environment to attract investment and boost the economy. However, the speed, direction and lack of consistency of change remain challenges that are likely to make the market less attractive to foreign investors despite several emerging business possibilities for first-movers. New and old practices and structures clash and cause uncertainty of the accepted practices and rules to play on the market. This is visible as institutional voids and changing institutions, as the changes remain poorly regulated, directed and enforced by the state. Businesses can and have

overcome the voids and complexities of the market by gaining social acceptance for the business, understanding the importance of networks and a local partner, as well as by taking action to solve institutional problems themselves by filling a void. However, large economic player and business groups remain absent, which leads to the conclusion in this study that for social development-driven entrepreneurs and organizations the market offers a fruitful soil with numerous opportunities, given that immediate and significant creation of financial value is not the main goal of the business. North Korea as an economy and a country may significantly benefit from social development-driven actors through the introduction of e.g. new skills, ideas, concepts and technologies that accelerate the development of the market through ordinary people.

Interestingly, the characteristics of the North Korean market and explored ways to overcome institutional voids did not significantly differ from the general characterization of developing markets: institutional voids and uncertainty about accepted rules, rapid abandoning of old structures that are replaced with developing structures lack institutionalization and are poorly directed and enforced. Moreover, the use of networks, relationships and partnerships are widely argued to substitute for lacking institutional structures, showing that also ways to overcome voids follow a pattern established for developing markets in general. It is thus concluded that strategies and ways that work in different developing markets may also prove successful in the North Korean market. Thus the North Korean market need not be seen as impossibly unique despite its peculiarities. The demonization and mystification of the market as well as speculation of reform and opening up may be viewed critically despite their useful viewpoints. However, an accompaniment of realistic and up-to-date research concerning the market is highly recommended.

The development of the North Korean market can be said to be in its infancy and the country's institutional framework remains underdeveloped in several aspects. However, in the capital a middle class is emerging rather rapidly. Moreover, social change is rolling with good speed, highlighting women's growing role in the market - however forcibly due to lack of official work and insufficient salaries – and stressing the importance of entrepreneurship. The North Koreans have become increasingly familiar with more capitalist market practices and consumer goods including e.g. mobile phones, make-up and western-style clothing. Young university students learn business practices and develop business ideas, regarding themselves already as a change-driving force in the economy. Thus it can be concluded that it is to a great degree the people that drive the change and development of the market – a down-to-up -development that can be expected to continue and grow. The education level, skilfulness and ability to learn very quickly were brought up as positive facts by almost every business that was reviewed for this study. This study concludes that the above mentioned findings have largely been overlooked in the Western media, even though they signal the recent development of the

market and can be seen as highly important catalysts for the future development of the North Korean market's potential. In addition to all its challenges, peculiarities and isolation, North Korea is a market consisting of actively thinking individuals and actors that drive the development and are more aware of the state of the country than often thought in the West. The true state of the market is hidden under mystification and even demonization of the country, with contrary responses to sudden reform and opening up. The need to look behind media and socialist veil highlights the need for more up-to-date and realistic research on the North Korean market.

## **6.2 Theoretical conclusions**

Institutional theory was used as a lens and the framework developed by Khanna et al. (2005, 7-8, 11-13) for spotting institutional voids was used as a tool to examine the structures of the North Korean market in a defined and consistent manner. Even though it was not the main goal to test an existing theory in this study, the practicality and applicability of the framework was still put to test. Thus this study provides an empirically -based test of the framework and broadens the existing literature on mapping the institutional structures of a market in general. Comprehensive studies concerning the market structure of North Korea remain very scarce, and thus this study provides a contribution to the field. The theoretical research base concerning North Korea is thus broadened, which can add to the understanding of North Korea as a potential market in the future. Further studies are however highly needed to complement the existing research base.

As regards to exploring possibilities to overcome institutional voids, only overlapping discussions were found instead of a developed framework. Thus this study contributes in unifying the discussions under one theme. Institutional voids are a theme recognized in the literature, however only few engage in the theme of how to overcome voids. The overcoming of institutional voids is crucial to companies seeking possibilities in developing markets that are characterized by a lack of market-supporting institutions. Thus this study aims to be of practical help to organizations by broadening the spectrum of possibilities to overcome voids. Moreover, the possibilities to overcome institutional voids were also found to be possible to use as a step-by-step approach. These findings may serve as preliminary development of the theoretical domain and hypothesis creation. In the future it should be striven for a more comprehensive and detailed theoretical framework for overcoming institutional voids, which companies could utilize as a tool when conducting business operations in uncertain and underdeveloped markets. Thus empirical research concerning strategic and more firm-specific possibilities to overcome institutional voids is urgently needed, as the possibilities in this study remain general and are constructed for the purpose of this study. However, the discussion and findings of this

study can be of use in development of further hypotheses or a more universal framework to overcome institutional voids, which also reflects the exploratory nature of the equivalent theme.

It can be said that Khanna et al.'s (2005, 7-8, 11-13) framework provided the needed structure to map both the market's contextual and market-level institutions, also including the informal structures that affect the market. Moreover, it guided towards a reality-based approach on the market's actually existing and missing institutions by steering the data analysis in the classification system. Thus little room was left for overly negative or positive speculations, which the author intended to avoid. It can be argued that a more detailed framework could have yielded more accurate results. Moreover, the applicability of the framework to culturally, historically or structurally different markets can be questioned to some extent, as the framework consists of readily given pieces that, if unaltered, may or may not reveal the essential structures of the target market. However, the framework left enough room for customizing it to the needs of the study and allowed for unexpected findings to be included. Moreover, this study targeted individuals and companies foreign to the North Korean market, which called for a more general than detailed and culturally bound framework.

### **6.3 Managerial conclusions**

The purpose of this study was to provide a holistic view of the North Korean market structure and provide insights of how to overcome challenges arising from missing market structures. Thus it aimed to provide holistic economic information of a market that remains unknown to individuals and organizations that find interest in the future possibilities of the market. In the light of the recent development clearly visible in this study, managers can benefit from the understanding of the state of the North Korean market. The study has concluded that North Korea should not simply be dismissed as a potential market due to its visible seeds of growth, which, if guaranteed continuation and growth, can be expected to lead to a creation of a potential market in the future. As young North Koreans grow up and are educated in a market-oriented climate where understanding of business is a central theme, the amount and quality of companies is likely to increase. The development of institutional structures can be expected to follow, however it remains the task for the governmental authorities to enable the changing of structures to support growth on a large scale. The seeds of growth are clearly visible in the bottom-up change, however legal and institutionalized structures are urgently needed to boost the development. It can be expected to take time – even if the political willingness is vaguely visible, uncertainty, inexperience and lack of trust in addition to structural voids inhibit the potential of the market.

The market of North Korea is changing rapidly as a result of a bottom-up marketization, which is likely to continue and become more institutionalized in the future. As developed economies are struggling with lagging growth rates, small and large companies are looking for business opportunities in emerging and developing markets. Managers may benefit from this study as a source of an overview to the market's structures and familiarization to its functioning, as the study consists of information from various sources. Moreover, the study provides previous experiences of companies active in North Korea and first-hand experience of the interviewees that have been actively engaged with North Korea for several years. Managers may use the experiences to complement the understanding of the market structures and thus rapidly find suitable fields of business, strategies and ways to navigate in the market. Managers and companies that do their homework early, can rapidly create competitive advantage and utilize the market's potential as the market institutions are developed to support businesses more effectively.

The study was conducted based on as realistic and fact-based a view as possible. Thus it aims to provide information without unrealistically positive or unnecessarily negative approach. The underlying manner of the study is valuable for managers as it offers carefully selected information and a variety of views for individuals and organizations to evaluate the potential of North Korea as a market. A balanced view enables to grasp the current market structure with its development and challenges in a single study, sparing the time to gather comprehensive material from a scratch. Moreover, the framework used in this study can be used as a concrete tool by managers as such to evaluate the market institutions of North Korea. It may also be modified to include more aspects that are found as crucial firm-specifically, and allows thus firm-specific differences and preferences to be included. The framework also allows comparison of same themes with other significant markets of operation, which may help in comparing firm-specific strategies and experiences with a new market. The market develops rapidly, and thus it is naturally recommended to find a broad spectrum of data in addition to this study.

The exploration of possibilities to overcome institutional voids provides market-specific insights to how to cope with some of the challenges of the market. Thus managers can benefit from the proposed solutions to the challenges by reflecting them to the organization-specific strategy and goals. Findings to overcome institutional voids corresponded with the possibilities found in previous literature that is based on numerous research and a great variety of emerging and developing markets. It suggests that North Korea has similar challenges, lacks and substituting systems that are characteristic of several economies in the infancy of their development. Thus it is concluded that similar possibilities to overcome institutional voids, which are used in many developing countries, may be fruitful in North Korea. This suggests that despite its challenges, the North Korean market may not be as unique and challenging a market to enter as is often

pictured. By combining strategies often used in developing market with the understanding of market institutions in North Korea, can formulate strategies suitable for the North Korean market. Furthermore, a hierarchy was constructed in this study for the possibilities to overcome institutional voids. Managers can use the hierarchical system of possibilities as a roadmap to proceed in the market in order to overcome institutional voids in the market. This can also be included in the strategy to guide the timeline of different phases of business.

#### **6.4 Limitations and suggestions for future research**

The current study focused only on economic matters and thus did not take various socio-political issues into account. However, the need for economic research was established as highly urgent, as the availability of political and socio-cultural research was more abundant. For a foreign company, the familiarization to political and socio-cultural matters is highly recommended to understand the North Korean market. The study focused mostly on formal economic institutions of the market, and did not include a thorough familiarization to the informal institutions such as conventions, culture, norms and values, even though it was found in this study that some informal structures are undergoing significant changes. These are important for a foreign organization to recognize, however, due to the focus on institutional voids that cannot exist in the informal structures, the focus lied mostly on the formal institutional structures. Further familiarization to the informal institutions of the market may be done with cultural studies.

Due to scarcity and scattered nature of information available, this study can hardly provide a perfect picture of the market. However, combined with other research from renowned sources, it gives a realistically grounded overview and evaluation tool of the structures, recent development and challenges of the North Korean market. The possibilities to overcome institutional voids remain on a market level and thus may not be directly applicable as strategies to a specific organization. However, the study provides responses that arise from the market's actual conditions. Moreover, broader possibilities were sought after as the study aimed to be of use to foreign individuals and organizations interested in the market. The findings of this study may be of use far in the future. However, as the data has been collected and analyzed openly with scientific methods, the findings can be used as tools for evaluation of and familiarization to the North Korean market.

The need for more research on the North Korean market remains urgent, as holistic and up to date research on the North Korean market remains scarce, which partially inspired the conduction of this study. Concentration on a part of the market, e.g. on the contextual structures or structures of the capital market could contribute by bringing more

detailed information about the market. Moreover, research on the informal structures of the market remains a highly significant topic for further research as this study shows that the informal structures are undergoing significant development.

The possibilities to overcome institutional voids is a subject of research which calls for significant contribution in broader context than only North Korea. The topic remains poorly defined and underexplored, even though research could significantly benefit companies that seek presence in developing and institutionally weak markets. This study aimed to offer insights to develop the subject further and possibly contribute to formulation of future hypotheses that may be tested in the context of the North Korean market and possibly applied to broader contexts. It can be stated that smaller, flexible actors with possibly social-driven causes are the most common form of foreign companies in the market. Thus further research concerning the process of institutional or social entrepreneurship in the North Korean market could bring significant value to individuals and organizations interested in opportunity recognition in the North Korean market.

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## APPENDIX 1: DATA SOURCES

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## **APPENDIX 2: FRAMEWORK FOR THE EXPERT INTERVIEW**

### **Taustatiedot**

1. Professional information
2. How have you gathered information concerning North Korea?

Please share your view concerning following themes:

### **Theme 1: Institutional environment**

#### 1. Formal institutions

- a. How are the following systems and institutions constructed? How do they function?
  - Political system: state, parties, government
  - Judicial system: court system, contracts, property rights
  - Economic system: capital market, labour market, product market
  - Media
  - Advertising and marketing
- b. How stable is the institutional environment? Which systems remain stable, which face changes?
- c. How is foreign investment regulated and supervised? How is the level of consistency, proneness to changes and strictness?
- d. Does the state encourage/prohibit certain modes of entry?
- e. Does the state/judicial system encourage/prohibit certain fields of business?

#### 2. Informal institutions

- a. How are the values, norms and attitudes towards business in general? Can changes be seen after the leadership change?
- b. How are the values, norms and attitudes towards foreign investment?

### **Theme 2: Institutional voids**

1. What kind of institutions or actors remains absent in the market, that could be significant for foreign companies? Are there any substitutes?
2. How does the North Korean market differ from western markets in relation to e.g. below mentioned systems?
  - Political and judicial systems: regulations, corruption, court system
  - Capital market: banks and insurances, capital and loans, stock market, auditing standards, business analytics, investment banking, bankruptcy process

- Product market: product information, market information, media, certification standards, retailers, production and supply chain
- Labour market: educational institutes, certification of universities, recruiting, career advising, labour unions, unemployment insurance

### **Theme 3: Overcoming institutional voids**

1. What kind of a significance does political and social acceptance have? (Legitimacy)
2. Networks
  - a. How significant is the building, nurturing and utilization of networks and relationships in business?
  - b. Which actors/institutions would be important to have networks with?
3. Partnering and cooperating
  - a. How significant is a local partner in business?
  - b. Momentarily, how is the situation to look for a business partner and engage in contracts?
  - c. Could it be possible to cooperate with an existing company in North Korea?
  - d. Could it be possible to cooperate with a conglomerate or a business group?
  - e. Momentarily, how is the situation to access resources in the market? (raw materials, employees, property)
  - f. Momentarily, how is the situation for mergers and acquisitions? (contracts, enforcement, capital market)

### **Theme 4: Other significant themes**