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Murat Doral
Kennesaw State University, mdoral@kennesaw.edu

Michael Patrono
Kennesaw State University, mpatrono@kennesaw.edu

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Murat Doral and Michael Patrono

The Korean economy is based on a government led and export oriented growth model centered on business groups or conglomerates known as chaebŏls which have close relationships with the government. The government led growth model, also known as Guided or Managed Capitalism, relies on a government dominated, but privately owned, business sector. The private business sector is itself dominated by chaebŏls which are family owned or controlled business groups. These groups are supported by preferential relationships with the government. While the chaebŏl system was an important element of South Korea's early industrial growth, it ultimately had to be reformed. The access to cheap and easy credit as well as protected domestic markets led many chaebŏls to make poor investment decisions. The weaknesses of the chaebŏls became apparent during the Asian financial crisis. Many of them collapsed in a short period of time because they were heavily invested in export-oriented industries, and thus exposed to the risk of a downturn in foreign markets.

Introduction

The South Korean economy is based on an export led growth model centered on business groups or conglomerates known as *chaebŏls*. The *chaebŏls* are themselves modeled on the Japanese system of *keiretsu*, but with homegrown modifications. In this paper we will examine the impact of *chaebŏls* on the economic growth of South Korea from the end of World War II until the end of the 1990's.

South Korea's government led growth model, also known as Guided or Managed Capitalism, relies on a government dominated, but privately owned, business sector. The private business sector is itself dominated by *chaebŏls* which are family owned or controlled business groups. These groups are supported by preferential relationships with the government. These relationships give government control over the allocation of financial resources which are used to direct firms into specific areas of industry that the government has identified as areas of competitive strength. Through control of the banking system the government encourages private investment in industry by granting easy and cheap access to capital, as well as control over imports that compete with the *chaebŏls* in the Korean domestic market. In return for this government provided support the owners of the *chaebŏls* agree to make large investments in, and expand production of goods for the export market. By means of this strong government steering of access to credit, South Korea made an initial place for itself among the major industrialized countries of the world.

While the *chaebŏl* system was an important element of South Korea's early industrial growth, it ultimately had to be reformed. The access to cheap and easy credit as well as protected domestic markets led many *chaebŏls* to make poor investment decisions. The weaknesses of the *chaebŏls* became apparent during the 1997 Asian financial crisis. Many companies collapsed in a short period of time because they were heavily invested in export-oriented industries, and thus exposed to the risk of a downturn in foreign markets. In the name of expansion they built up excess production capacities under the protection of the government.

Following the Asian financial crisis, South Korean government leaders insisted that Korean *chaebŏls* look to the outside world for growth, but without government help or protection. This free-market orientation put Korea and the *chaebŏls* in an arena much larger than the national market, and put success sufficiently outside the control of domestic politicians that the firms had to adopt competitive market strategies to survive and prosper. While the government provided support, such as cheap credit and domestic market protection, helped at an early stage of development, growth is ultimately independent of government help. Success or failure is determined by response to competitive pressures in global markets based on comparative advantage. In this new era Korea's success is the result of an emphasis on market competition, investment in new technologies and human capital, and a reduction in government protection of the *chaebŏls*.

South Korean Economic Development

The case of South Korea, while not unique, is an impressively instructive example of a country that followed a different path from the one pursued by most developing nations after World War II. Several countries in the East Asia, commonly known as the "Asian Tigers", also embarked on a predominantly market led growth path. South Korea, the most prominent of the Tigers, is especially interesting considering the daunting obstacles that had to be overcome, the speed at which the country developed, and the degree to which the country has reached full development on par with the West.

Like many other developing economies during the 1960's, South Korea initially adopted the government led growth model to jump-start rapid industrialization, though with some significant differences. First, the South Korean government pushed for the private sector to invest in targeted industries rather than building a state owned sector as India did. To that end, the government provided the means of financing and market protection. Second, unlike many developing nations, the government adopted an export orientation as part of their economic policy. Instead of focusing on the smaller domestic market, South Koreans decided to go head to head with the companies in the more advanced economies in global markets, and despite all the troubles and turmoil this engendered they modernized their economy and society in a single generation (see Table 1).

Table 1: Sectoral Composition as a percent of GDP

2009-2010	Agriculture	Industry	Services
South Korea	3%	39%	58%
Argentina	9%	33%	57%
Turkey	9%	28%	63%
Brazil	6%	29%	66%
India	18%	29%	52%

Source: World Economic Forum – World Competitiveness Report 2009-2010, (p. 55).

South Korea is a country located in East Asia and neighbored by China to the west, Japan to the east, and North Korea to the north. Its territory covers a total area of 38,502 square miles (smaller than the state of Georgia) and has a population of over 48 million (close to 25% larger than California), making it the one of the most densely populated countries in the world (See Table 2).

Table 2: Korea and United States

	Population	Surface Area	Population/Sq.Mi.
United States	310,232,863	3,794,099	81.77
South Korea	48,636,068	38,502	1263.21

Source: Retrieved from the CIA World Factbook. https://www.cia.gov/library/publications/the-world-factbook/

In recent history, South Korea achieved and sustained high rates of economic growth despite the fact that it is under constant threat by North Korea across the 38th parallel. It has been particularly successful in modernizing its economy and bringing prosperity to its citizens at a much larger scale compared to other Asian Tiger economies. In fact, through this rapid growth, South Korea has been able to transform itself into a highly sophisticated, knowledge based, industrialized, and competitive export economy.

According to rankings published by the World Economic Forum, South Korea has several competitive strengths such as a world class infrastructure, strong macroeconomic policy, an excellent educational system, and an innovative spirit, making South Korea a global competitor to be reckoned with. However, it has several weaknesses as well, which are mostly related to public sector inefficiencies and its institutional framework. These weaknesses include labor market rigidity, a fragile banking sector, institutional quality issues, mistrust of politicians, and government red tape (See Table 3).

Table 3: World Competitiveness Rankings

Overall Competitiveness	19th
Strengths	
World-class infrastructure	17th
Strong macroeconomic stability	11th
An excellent higher educational system	16th
One of the world's innovation powerhouses	11th
Weaknesses	
Labor market flexibility	118th
Financial market, particularly the banking sector	90th
Quality of its institutions	53rd
Mediocre level of trust in politicians	67th
The perceived opacity of policymaking	100th
The burden of red tape	98th

Source: World Economic Forum – World Competitiveness Report 2009-2010, (p. 29).

How was it possible for a crowded Asian country with very limited natural resources to achieve such economic success and move from an agricultural based economy to a high tech, knowledge-based economy in a single generation? Even though the answer is multi-faceted, there is one important factor that separated South Korea from most developing nations: the adoption of market-friendly economic policies and the adoption of an "outward looking" export orientation. After World War II, while most of the world was moving away from the market system and capitalism and toward the command system and socialism, South Korea, along with a handful of other East Asian countries, took the chance and moved in the opposite direction. Even though its policy makers initially relied on the guiding hand of the government and continually intervened through trade barriers and credit allocation, South Korea's policy makers promoted aggressive competition in export markets. Like other Asian Tigers, South Korea had business and market friendly governments who got the economic fundamentals right with high domestic savings rates, low inflation, export orientation, and emphasis and commitment to education (Yergin & Stanislaw, 2002, p. 141).

This choice of market orientation was by no means foreordained. Right from the founding of modern Korea there were powerful political currents moving in the opposite direction. The modern nations of North and South Korea, which had previously been annexed by Japan since 1910, were formed on the Korean peninsula after World War II. The Korean War, which lasted for three years from 1950 until 1953, further solidified the two nations into hostile camps. The division of Korea not only separated the Korean people into two separate countries but also created two very different economic systems. North Korea became a communist dictatorship while South Korea eventually became a democracy with a capitalist based economy. In addition, in 1945 when the Korean peninsula was partitioned, the South had been left with very little industry since the north had historically been the most heavily industrialized part of the peninsula (Yergin & Stanislaw, 2002, p. 151).

While North Korea adopted a centrally planned command economic system under communism, South Korea adopted a market based economic system under American tutelage. Today, 56 years after the end of the War, South Korea is a newly industrialized economy that can compete successfully on a global scale with the companies of more advanced countries. On the other hand, North Korea has a closed economy, is a suppressive dictatorship, and its population suffers from very low standards of living (See Table 4).

Table 4: Korea's GDP

2008	Population	GDP-PPP	GDP per Capita
South Korea	48.6m.	\$1,467 b. (2010)	\$30,200 (2010)
North Korea	22.8m.	\$40b. (2009)	\$1,800 (2009)
2008	Agriculture	Industry	Services
South Korea	3%	39.5%	57.6%
North Korea	23.3%	43.1%	33.6%

Source: Retrieved from CIA World Factbook. https://www.cia.gov/library/publications/the-world-factbook/

The real push for development and industrialization came in 1961, when Army General Park Chung Hee took power through a military coup. Despite having suffered significantly under Japanese colonialism from 1910 until the end of World War II, Park modeled the Korean economy on the Japanese model of export orientation. The Korean model which came to be known later as "the Economic Miracle on the Han River" was a combination of government intervention and market economics with a focus on heavy industrialization and export-led economic growth. This was mainly done for two reasons: export orientation was chosen to offset the effects of declining American aid, and heavy industrialization to counter the much stronger North Korean military machine (Yergin & Stanislaw, 2002, pp. 152-153). The primary engine of economic growth became exports, a strategy that was due to the lack of land resources, a limited domestic market, and a well educated workforce. To this end, *chaebŏls* became the tools of this export-oriented and outward looking industrialization strategy as a way to achieve rapid growth and prosperity.

Chaebŏls

The creation of *chaebŏls,* family controlled but government assisted conglomerates or corporate groups, came later when economic policy makers realized that in order for the Korean companies to compete on the global stage for export earnings large firms had to be created. The *chaebŏls* came to dominate the Korean economy and are the main export generating global competitors. The *chaebŏls* were modeled after Japanese *keiretsu,* but with significant differences:

1. The most important difference between the Japanese *keiretsu* and Korean *chaebŏls* is that while a *keiretsu* was organized around a commercial bank, *chaebŏls* were prohibited from forming and owning banks.

2. While *chaebŏls* are still largely controlled by their founding families, Japanese *keiretsus* are controlled by professional managers. Therefore, *chaebŏls* have a more centralized structure but *keiretsus* are more decentralized.

3. *Chaebŏls* often rely on their own subsidiaries to produce components, but *keiretsus* frequently use sub-contractors. The *chaebŏl* model is based on a complex and intricate system of interlocking ownerships. In many cases, the owners of a *chaebŏl*, along with family members, and even senior managers from their subsidiaries, control several businesses which may control other businesses that control the subsidiaries.

In the 1960's, the Park regime had nationalized the banks in South Korea in order to control the allocation of credit to favored industries and firms. The government had granted *chaebŏls* access to easy and cheap credit and privileges. In many cases, certain *chaebŏls* grew not because they were efficient and profitable but because of this access. The weaknesses of some of the *chaebŏls* became apparent during the Asian financial crisis of 1999 when many of them did not generate enough cash flow to pay their debts and went bankrupt.

Following the assassination of President Park in 1979 by the head of the Korean Intelligence Agency, yet another army general, Chun Doo Hwan, came to power and immediately set out to stabilize the country. With the help of Stanford trained economist Kim Jae-Ik, South Korea rapidly changed course in terms of economics and politics. Over time and despite massive government help, the *chaebŏls* had grown inefficient and could not survive without government subsidies or even bailouts. Kim's suggestion was to reduce the size and scope of government intervention by pulling back the economic frontier of the state from the economy (Yergin & Stanislaw, 2002, p. 151). Subsequently, South Korea never looked back and adopted economic policies aimed at less interventionist indicative planning, sold off some government owned enterprises, deregulating the financial sector, and reduced import barriers to expose the *chaebŏls* to greater competition (Yergin & Stanislaw, 2002, p. 155).

Through significant government support and competitive strengths acquired over time, some of the *chaebŏls* such as Samsung, Hyundai, LG, and others became household names around the world (See Table 4). In fact, Samsung alone is responsible for about 20% of South Korea's exports. Moreover, Samsung Electronics is the world's largest electronics company, the largest producer of memory chips, and second-largest chipmaker. Samsung Heavy Industries is also the world's second largest shipbuilder, and Samsung C&T is a well-known construction company with a significant global presence. On the other hand, Hyundai Motors is the world's fourth largest automaker after Toyota, GM, and Volkswagen in terms of unit sales and fifth in terms of dollar sales. Also, Hyundai Heavy Industries is the world's largest shipbuilder. The third biggest *chaebŏl*, LG Group, is also a dominant global competitor in a number of key markets. For example, Samsung and LG together produce 50% of the world's LCD televisions. Also, LG is the world's second largest manufacturer of TVs and third largest manufacturer of mobile phones.

Despite the fact that *chaebŏls* make an enormous contribution to the South Korean economy and provide employment opportunities, many of them, instead of focusing on their core competencies, run and operate unrelated businesses and many of their subsidiaries and affiliates are not profitable (See Table 4).

Conclusion

Regardless of the deficiencies of the *chaebŏls*, and the over dependence on export markets, today South Korea is a parliamentary democracy and has a dynamic capitalist economy which is ranked as the 13th largest economy in the world (CIA World Factbook, 2010). From the early 1960's until the 1997 crisis, the South Korean economy has been one of the fastest growing economies in the world (see Table 5). In just more than three decades, this rapid and sustained growth pushed South Korea from the ranks of the poorest countries in the world into the ranks of major industrialized countries of the world. The key to the South Korean success was the adoption of outward looking economic and development policies, large investments in education and human capital, and a willingness to adapt and reform to remain competitive in the global economy.

Table 4: Korean Corporations

	2009	Global	Revenues	Profits	Profit Margin	Assets	Equity
		500 Rank	($ millions)	($ millions)	(%)	($ millions)	($ millions)
1	Samsung Electronics	32	$108,927	$5,027	4.56%	$83,601	$46,141
2	LG Group	67	$78,892	$830	1.01%	$51,433	$4,948
3	SK Holdings	72	$80,810	$259	0.32%	$55,499	$5,373
4	Hyundai Motor Corporation	87	$72,542	$780	1.08%	$81,938	$15,140
5	POSCO	199	$37,976	$3,984	10.49%	$37,284	$21,963
6	GS Holdings	213	$36,503	$102	0.28%	$18,348	$2,818
7	Korea Electric Power	305	$28,712	-$2,689	-9.36%	$70,024	$32,521
8	Hyundai Heavy Industries	355	$25,004	$2,051	8.20%	$30,469	$4,507
9	Hanwha	362	$24,782	$267	1.08%	$55,257	$1,366
10	Samsung Life Insurance	367	$24,420	$93	0.38%	$87,957	$5,372
11	Korea Gas	438	$21,076	$301	1.43%	$17,421	$3,238
12	S-Oil	441	$21,020	$406	1.93%	$6,119	$2,694
13	Doosan	471	$19,494	$98	0.50%	$26,035	$1,228
14	Samsung C&T	495	$18,635	$315	1.69%	$12,260	$3,887
			$603,406	$11,824	1.96%	$633,645	$151,194

Source: Retrieved from CNNMoney.com/FORTUNE - Annual Rankings of the World's Largest Corporations.

http://money.cnn.com/magazines/fortune/global500/2010/countries/SouthKorea.html

Table 5: Economic Growth Indicators for South Korea

S. Korea	GDP-PPP	Exports	Imports	Trade Balance	Trade Volume
1988	$ 383,164.64	$ 72,996.13	$ 67,399.61	$ 5,596.52	$ 140,395.74
1989	$ 409,007.12	$ 70,096.16	$ 77,216.48	$ (7,120.32)	$ 147,312.64
1990	$ 446,452.62	$ 73,217.59	$ 87,209.90	$ (13,992.31)	$ 160,427.49
1991	$ 488,388.59	$ 81,325.13	$ 103,705.20	$ (22,380.07)	$ 185,030.32
1992	$ 517,084.80	$ 91,250.88	$ 107,783.47	$ (16,532.59)	$ 199,034.35
1993	$ 548,801.53	$ 102,341.65	$ 113,615.99	$ (11,274.34)	$ 215,957.64
1994	$ 595,650.21	$ 119,003.59	$ 137,914.41	$ (18,910.82)	$ 256,918.00
1995	$ 650,265.05	$ 148,022.89	$ 167,778.73	$ (19,755.84)	$ 315,801.61
1996	$ 695,774.77	$ 166,029.87	$ 190,860.37	$ (24,830.50)	$ 356,890.25
1997	$ 728,134.81	$ 201,935.96	$ 196,880.07	$ 5,055.90	$ 398,816.03
1998	$ 678,225.10	$ 227,485.33	$ 148,101.21	$ 79,384.12	$ 375,586.54
1999	$ 742,563.73	$ 260,747.79	$ 196,607.91	$ 64,139.87	$ 457,355.70
2000	$ 805,578.99	$ 310,665.04	$ 238,153.10	$ 72,511.94	$ 548,818.15
2001	$ 837,588.38	$ 300,021.02	$ 223,158.46	$ 76,862.56	$ 523,179.49
2002	$ 897,476.10	$ 336,316.77	$ 256,712.84	$ 79,603.93	$ 593,029.61
2003	$ 922,630.35	$ 385,025.48	$ 289,281.60	$ 95,743.89	$ 674,307.08
2004	$ 965,246.96	$ 461,038.30	$ 321,648.84	$ 139,389.46	$ 782,687.14
2005	$ 1,003,443.26	$ 496,864.48	$ 345,114.32	$ 151,750.16	$ 841,978.79
2006	$ 1,055,408.31	$ 553,339.76	$ 384,852.67	$ 168,487.09	$ 938,192.43
2007	$ 1,109,295.72	$ 623,090.83	$ 426,710.62	$ 196,380.21	$ 1,049,801.45
2008	$1,133,965.44	$658,814.92	$ 446,307.67	$ 212,507.25	$1,105,122.60
Growth Rate	5.57%	11.63%	9.91%		10.87%

Source: Retrieved from the Organization of Economic Cooperation and Development – OECD.StatExtracts – 2008. http://stats.oecd.org/Index.aspx

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