# Restructuring of the Chaebols and Financial Sestor in Korea：Progress and Assessment Since the Financial Crises

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# RESTRUCTURING OF THE CHAEBOLS AND FINANCIAL SECTOR IN KOREA: PROGRESS AND ASSESSMENT SINCE THE FINANCIAL CRISIS

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# I. Introduction

Korea's leading conglomerates (*chaebols*) and financial institutions are currently undergoing dramatic restructuring under the watchful eyes of the International Monetary Fund (IMF) and the Korean government. The financial crisis, which swept through much of Asia in 1997, forced the Korean government to sign a Stand-by Agreement Package with the IMF on December 3, 1997. The IMF agreed to provide a $58 billion loan in exchange for various structural reforms in South Korea including that of the *chaebols* and financial institutions, since these two institutions were seen as the largest culprits of the financial crisis.

The crisis resolution has gone through three stages in chronological terms. Immediately after the crisis, the stabilization of foreign exchange market was the most urgent mandate. Therefore, the IMF imposed high interest rate policy in tandem with the provision of rescue loans. The resulting current account surpluses as well as the successful rescheduling of short-term foreign debt of the banking sector contributed to restoring currency stability. In the second stage, which started from April 1998, the Korean government shifted its policy focus from currency stability to restructuring of both the financial and corporate sectors. In September of that year, the first round of financial restructuring was implemented with the injection of fiscal resources designed to support the disposal of non-performing loans (NPLs) and recapitalization of banks. This measure helped significantly to alleviate the severe credit crunch, which had caused massive corporate bankruptcies. The third stage beginning from October 1998, witnessed the expansionary macroeconomic policy with a rapid downward adjustment of interest rates and fiscal expansion while corporate restructuring particularly for the top five *chaebols* accelerated on the basis of the agreement on restructuring principles and measures between the government and business leaders.

Korea's corporate and financial restructuring has resulted in significant progress, in fact, unprecedented by Korea's own historical standards. The largest *chaebols* reduced their debt leverage to achieve the target goal of 200% debt/equity ratio by the end of 1999, while business restructuring proceeded with mergers, swaps and spin-offs. Corporate governance reform has also produced new standards and practices conducive to enhanced transparency and accountability. The financial sector removed NPLs and improved the capital base significantly with the help of fiscal support by the government. At the same time, prudential regulation and supervision was strengthened with the application of stricter standards in capital adequacy and risk management.

Nevertheless, Korea's economic restructuring is by no means complete. Financial institutions still have sizable amount of NPLs and are under-capitalized by international standards. The total indebtedness of the corporate sector as a whole still remains effectively at the same level as that prevailed in the pre-crisis period, although the *chaebol*'s debt/equity ratios declined significantly mainly due to the inflation of equity capital by "circular investment." Given these deficiencies, the financial market continues to be vulnerable to cyclical shocks and changes in market sentiments.

After two years of reform since the onset of the crisis, it is necessary to identify the strengths and weaknesses of Korea's corporate and financial restructuring, and assess the interim progress. To this end, this study examines whether there have been real changes in the corporate and financial sectors, and attempts to evaluate not only the true significance of changes but shed light on the future reform agenda. Such exercise is particularly important since many past restructuring efforts in Korea have failed.

Section II includes detailed description of the financial landscape of the *chaebols*. The section investigated the role of the *chaebols* in the financial crisis, and analyzed financial vulnerability of the *chaebols* by utilizing a comprehensive firm-level data set that covers more than 6,000 firms in total. The study also addresses the distorted linkage between the *chaebols* and the financial sector that have prevailed for decades, and the adverse effects of policy loans and bail-out policy in the past on the financial health of the *chaebols*.

Section III delineates corporate restructuring measures, and then provides assessment on the interim progress in corporate restructuring. As to restructuring measures, the analysis presents summaries of de-leveraging, business restructuring, and corporate workout programs. The assessment part of the section addresses unresolved problems in each modality of corporate restructuring, including the continued high leverage of the *chaebols* and related risks faced by financial institutions as can be seen in Daewoo's financial failure.

Section IV focuses on the changes in corporate governance in Korea's top five *chaebols* based on survey data. The study in this section starts with a brief description of institutional reform measures in the realm of corporate governance. In order to fill the lacunae of information on the actual changes in corporate governance and management practices, we attempted to conduct interviews of all member firms of the largest five *chaebols*. Although obtaining permission to interview was very difficult since many of the firms themselves were involved in corporate restructuring, the research provided a unique opportunity to examine corporate restructuring as it was occurring.

Section V examines financial restructuring measures and the changes in the relations between the *chaebol* and financial institutions before and after the crisis. The financial institutions had been criticized for weak internal governance and the inability to check the reckless expansion of the largest *chaebols*. This has been particularly so for *chaebol*-affiliated non-bank financial institutions (NBFIs) as they have been heavily indulged with insider trading and unfair practices. The study present an empirical study on the collusive relationship between the *chaebols* and *chaebol*-affiliated NBFIs and indirect evidence for implicit favors provided by those NBFIs to the *chaebols* in terms of availability and cost of funding. With these analyses, this section finally addresses future challenges in Korea's financial restructuring, including the privatization of banks and regulatory enforcement. Concluding remarks are included in Chapter VI.

# II. Financial Crisis and the *Chaebols*

Although Korea's financial crisis was triggered by foreign currency shortage in the financial institutions, there is little doubt that financial troubles of business conglomerates, known as *chaebols* in Korea, were at the epicenter of the crisis. A string of corporate bankruptcies occurred in early 1997, starting from Hanbo Steel Co. *Chaebols*' financial troubles were directly translated into unbearable burden of non-performing loans (NPLs) and the deterioration of the capital adequacy in the financial sector. These developments in the corporate and financial sectors undermined international confidence in the Korean economy, resulting in a massive and sudden pull-out by foreign investors.

## 1. Weak Financial Structure of the *Chaebols*

The weak financial structure of the corporate sector was the core source of its financial vulnerability. According to the flow of funds statistics shown in Table II-1, gross corporate debt amounted to 810 trillion won, equivalent to about 190% of GDP at the end of 1997. The financial vulnerability can also be seen from the high debt-equity ratios. In particular, Table II-2 shows that the average debt/equity ratio of the 30 largest *chaebols* reached 519 percent by the end of 1997. Moreover, the debt/equity ratios of those *chaebols* that later became bankrupt and/or subject to formal insolvency procedures were at an unsustainable level at the time of the crisis: Halla Group (impaired capital), Jinro Group (impaired capital), New Core Group (1,784%), and Haitai Group (1,501%).

Another important observation drawn from Table II-2 is that high debt/equity ratios had prevailed – in fact, had been increasing – for several years before the crisis. The rapidly rising debt/equity ratios of *chaebols* since 1995 can be partially attributed to such unfavorable cyclical shocks as the plummeted terms of trade in 1996 and business downturn since the end of 1995. Nonetheless, they were able to survive at least for two years before they collapsed at the time of the financial crisis, even with such an unbearable burden of debt.

## <Table II-1> Outstanding Liabilities of Korea's Corporate Sector

(Unit: trillion won, %)

| | 1980 | 1990 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|
| Loans by Financial Institutions | 17.4<br>(38.0) | 97.8<br>(44.6) | 272.9<br>(42.9) | 335.8<br>(41.5) | 312.2<br>(39.0) | 312.4<br>(38.7) |
| Banks | 11.1 | 50.1 | 130.9 | 161.1 | 156.3 | 170.3 |
| Investment & Finance Cos.[1)] | 0.9 | 9.7 | 16.4 | 18.3 | 12.1 | 10.4 |
| Insurance Cos. | 0.5 | 8.7 | 24.2 | 26.5 | 20.8 | 21.0 |
| Other Loans | 4.8 | 29.3 | 101.4 | 129.8 | 122.6 | 110.4 |
| Bonds | 3.3<br>(7.2) | 47.3<br>(21.6) | 195.1<br>(30.7) | 246.1<br>(30.4) | 276.9<br>(34.5) | 261.6<br>(32.4) |
| Short-term | 1.3<br>(2.8) | 16.5<br>(7.5) | 39.8<br>(11.0) | 73.9<br>( 9.1) | 62.2<br>(7.8) | 45.7<br>(5.7) |
| Commercial papers | 1.1 | 12.7 | 64.9 | 69.0 | 57.3 | 40.8 |
| Government & Public Bonds | 0.3 | 3.7 | 4.9 | 4.9 | 4.9 | 4.9 |
| Long-term | 2.0<br>(4.4) | 30.8<br>(14.1) | 125.3<br>(19.7) | 172.2<br>(21.3) | 214.7<br>(26.8) | 215.9<br>(26.8) |
| Debentures | 1.9 | 29.4 | 107.4 | 138.9 | 184.8 | 186.5 |
| Foreign Debentures | - | - | 12.3 | 27.2 | 23.2 | 22.7 |
| Government & Public Bonds | 7.4 | 1.5 | 5.5 | 6.1 | 6.7 | 6.6 |
| Trade Credits | 7.4<br>(16.2) | 27.1<br>(12.4) | 60.8<br>( 9.6) | 74.5<br>(9.2) | 66.9<br>(8.3) | 71.9<br>(8.9) |
| External Debts | 8.1<br>(17.7) | 14.6<br>(6.7) | 40.8<br>( 6.4) | 73.2<br>(9.0) | 54.9<br>(6.8) | 61.1<br>(7.6) |
| Others | 7.7<br>(16.8) | 29.2<br>(13.3) | 65.8<br>(10.4) | 80.0<br>(9.9) | 90.5<br>(11.3) | 100.1<br>(12.4) |
| Total | 45.8<br>(100.0) | 219.1<br>(100.0) | 635.4<br>(100.0) | 809.6<br>(100.0) | 801.5<br>(100.0) | 807.1<br>(100.0) |

Note: 1) Investment and Finance companies were transformed into Merchant Bank Companies in the mid-1990s.
*Source:* Bank of Korea, *Flow of Funds*, each year.

<Table II-2> Top 30 *Chaebols*' Debt/Equity Ratio

(Unit: %)

| 1995 | | 1996 | | 1997 | | 1998 | |
|---|---|---|---|---|---|---|---|
| *Chaebols* | Debt/ Equity Ratio | *Chaebols* | Debt/ Equity Ratio | *Chaebols* | Debt/ Equity Ratio | *Chaebols* | Debt/ Equity Ratio |
| 1. Hyundai | 376.4 | 1. Hyundai | 436.7 | 1. Hyundai | 578.7 | 1. Hyundai | 316.0 |
| 2. Samsung | 205.8 | 2. Samsung | 267.2 | 2. Samsung | 370.9 | 2. Samsung | 355.0 |
| 3. LG | 312.8 | 3. LG | 346.5 | 3. Daewoo | 472.0 | 3. Daewoo | 252.1 |
| 4. Daewoo | 336.5 | 4. Daewoo | 337.5 | 4. LG | 505.8 | 4. LG | 315.6 |
| 5. Sunkyung | 343.3 | 5. Sunkyung | 383.6 | 5. SK | 468.0 | 5. Hanjin | 458.3 |
| 6. Ssangyong | 297.7 | 6. Ssangyong | 409.4 | 6. Hanjin | 907.8 | 6. SK | 249.8 |
| 7. Hanjin | 621.7 | 7. Hanjin | 556.6 | 7. Ssangyong | 399.7 | 7. Ssangyong | 1,402.8 |
| 8. Kia | 416.7 | 8. Kia | 516.9 | 8. Hanwha | 1,214.7 | 8. Kohap | impaired capital |
| 9. Hanwha | 620.4 | 9. Hanwha | 751.4 | 9. Kumho | 944.1 | 9. Hanwha | 327.1 |
| 10. Lotte | 175.5 | 10. Lotte | 192.1 | 10. DongAh | 359.9 | 10. Kumho__ | 558.0 |
| 11. Kumho | 464.4 | 11. Kumho | 477.6 | 11. Lotte | 216.5 | 11. DongAh | 625.4 |
| 12. Doosan | 622.1 | 12. Halla | 2,065.7 | 12. Halla | impaired capital | 12. Hyosung | 281.2 |
| 13. Daelim | 385.1 | 13. DongAh | 354.7 | 13. Daelim | 513.6 | 13. Daelim | 335.8 |
| 14. Hanbo | 674.9 | 14. Doosan | 688.2 | 14. Doosan | 590.3 | 14. Anam | 8,550.7 |
| 15. DongAh Construction | 321.5 | 15. Daelim | 423.2 | 15. Hansol | 399.9 | 15.Dongkuk Steel | 198.8 |
| 16. Halla | 2,855.3 | 16. Hansol | 292.0 | 16. Hyosung | 465.1 | 16. Doosan | 331.7 |
| 17. Hyosung | 315.1 | 17. Hyosung | 370.0 | 17. Kohab | 472.1 | 17. Shinho | impaired capital |
| 18. Dongkuk Steel | 190.2 | 18. Dongkuk Steel | 218.5 | 18. Kolon | 433.5 | 18. Hansol | 458.7 |
| 19. Jinro | 2,441.2 | 19. Jinro | 3,764.6 | 19.Dongkuk Steel | 323.8 | 19. Kabul | impaired capital |
| 20. Kolon | 328.1 | 20. Kolon | 317.8 | 20. Dongbu | 338.4 | 20. Dongbu | 267.5 |
| 21. Tongyang | 278.8 | 21. Kohab | 590.5 | 21. Anam | 1,498.5 | 21. Kolon | 334.6 |
| 22. Hansol | 313.3 | 22. Dongbu | 261.8 | 22. Jinro | impaired capital | 22. Jindo | impaired capital |
| 23. Dongbu | 328.3 | 23. Tongyang | 307.8 | 23. Tongyang | 404.3 | 23. Tongkook Co. | impaired capital |
| 24. Kohab | 572.0 | 24. Haitai | 658.5 | 24. Haitai | 1,501.3 | 24. Haitai | impaired capital |
| 25. Haitai | 506.1 | 25. New Core | 1,225.6 | 25. Shinho | 676.8 | 25. Woobang | impaired capital |
| 26. Sammi | 3,244.6 | 26. Anam | 478.5 | 26. Daesang | 647.9 | 26. Tongyang | 306.0 |
| 27. Hanil | 936.2 | 27. Hanil | 576.8 | 27. New Core | 1,784.1 | 27. Saehan | 276.7 |
| 28. Kukdong Construction | 471.2 | 28. Keopyong | 347.6 | 28. Keopyong | 438.1 | 28. Byucsan | 655.4 |
| 29. New Core | 924.0 | 29. Miwon | 416.9 | 29. Kangwon Industrial | 375.0 | 29. Shinwon | impaired capital |
| 30. Byucksan | 486.0 | 30. Shinho | 490.9 | 30. Saehan | 419.3 | 30. Kangwon Industrial | 441.6 |
| Total | 347.5 | | 386.5 | | 519.0 | | 369.1 |

*Source:* Fair Trade Commission.

Upon the onset of the crisis, however, macroeconomic conditions changed dramatically in disfavor of the heavily debt-ridden corporate sector. The exchange rate of the won *vis-a-vis* the US dollar soared to the 1,950 level in December 1997, from a pre-crisis level of about 900. Such huge devaluation instantaneously inflated domestic-currency denominated value of foreign debt. Furthermore, the IMF imposed a high interest rate policy during the initial stage of crisis management in order to stabilize the currency market quickly. Accordingly, the call rate jumped from 14 percent to 25 percent and a rise in market interest rates soon followed. Such a jump in market interest rates, coupled with asset price deflation and severe credit crunch, caused massive corporate bankruptcies. During the first quarter of 1998, the monthly average number of corporate bankruptcies exceeded 3,000, representing about a 200 percent increase compared to the same period of the previous year (see Table II-3). Massive corporate bankruptcies directly translated into a dramatic increase in NPLs among financial institutions, seriously undermining the soundness of the financial system as well. By the end of June 1998, the total amount of non-performing loans (NPLs) of all financial institutions, broadly defined to include loans classified as "precautionary," reached about 136 trillion won (32% of GDP), a 58% increase from 86.4 trillion won at the end of 1997.

**<Table II-3> Bankruptcies**

(Unit: number of firms)

| | | Large firm | SMCs | Unincorporated | Total |
|---|---|---|---|---|---|
| 1996 | (yearly) | 7 | 5,150 | 6,432 | 11,589 |
| 1997 | (yearly) | 58 | 8,160 | 8,942 | 17,168 |
| | 11 | 17 | 697 | 755 | 1,469 |
| | 12 | 19 | 1,540 | 1,638 | 3,197 |
| 1998 | (yearly) | 39 | 10,497 | 12,292 | 22,828 |
| | 1-3 | 16 | 4,275 | 5,158 | 9,449 |
| | 4-6 | 8 | 2,847 | 3,502 | 6,357 |
| | 7-9 | 8 | 2,031 | 2,182 | 4,221 |
| | 10-12 | 7 | 1,344 | 1,450 | 2,801 |
| 1999 | (yearly) | 7 | 3,364 | 3,347 | 6,718 |
| | 1-3 | 2 | 925 | 1,005 | 1,932 |
| | 4-6 | 3 | 801 | 858 | 1,662 |
| | 7-9 | 2 | 760 | 715 | 1,477 |
| | 10-12 | 0 | 878 | 769 | 1,647 |

*Source:* Bank of Korea.

## 2. Financial Landscape of the *Chaebols*

In order to investigate the role of the *chaebols* in the financial crisis, it would be helpful to document the financial landscape of the *chaebols* in more detail. To this end, financial data of non-financial firms are analyzed. Specifically, the full sample includes 6,116 non-financial firms in total, all of which are subject to external auditing requirements. In addition, all firms in the sample have been in operation and financially non-bankrupt until May 1999. The sample period ranges from 1986 to 1998. The full sample is classified into three categories: affiliates of the top 5 *chaebols*, affiliates of the top 6-70 *chaebols*, and non-*chaebol* independent companies.

The analysis aims to assess the financial health of non-financial firms, both *chaebol* affiliates and non-*chaebol* companies, by using various indicators. Perhaps the most useful indicator would be the interest payment coverage ratio (IPCR), constructed as the ratio of operating earnings over interest expenses. The operating earnings used in this paper are EBITDA (Earnings Before Interest payment and Taxes plus Depreciation and Amortization). This definition implies that those firms with a ratio of less than 1 are at the risk of going bankrupt at any time and pose serious credit risks to their creditors.

Figure II-1 shows the time profile of IPCRs of *chaebols* and non-*chaebol* companies over the sample period. The ratios in the Figure are weighted average across firms in each category. Notable features of figure II-1 are that 1) the top 6~70 *chaebols* have been most vulnerable in terms of debt servicing capacity, and 2) the IPCRs of all three categories have been on a decreasing trend, despite short-term ups and downs. One exception is the IPCR of the top 5 *chaebols* over the period from 1994 to 1995. Such a blip in the IPCRs of the top 5 *chaebols* was largely due to the unprecedented boom in the semiconductor industry. Indeed, the rising pattern in the IPCRs of the top 5 *chaebols* during 1994-95 disappears when semiconductor-producing companies (Samsung Electronics, Hyundai Electronics, LG Semiconductor) are excluded from the sample.

At the time of crisis in 1997, the top 5 *chaebols* turned out to be more financially sound than smaller *chaebols* and non-*chaebol* companies. Specifically, the IPCRs of the top 5 *chaebols*, the top 6-70 *chaebols* and non-*chaebol* companies were 1.6, 0.95, and 1.29, respectively. Accordingly, the top 6-70 *chaebols* were in most serious trouble at the time of the crisis.

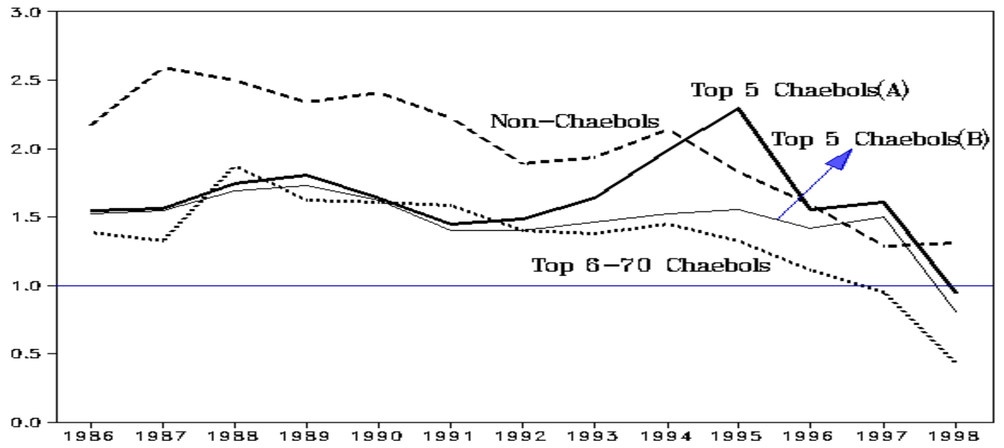
Such financial vulnerability of the top 6-70 *chaebols* has been attributed to prolonged poor business performance and high debt leverage. Business performance of the top 6-70 *chaebols*, measured as the ratio of EBITDA over total assets, has sharply deteriorated since 1995 (see Figure II-2) while their financial leverages continued to rise (see Figure II-3). Consequently, the return on assets (ROAs) of the top 6-70 *chaebols'* plunged to –2.0% in 1997 and –5.91% in 1998 from 1.04% in 1994 (see Figure II-4).

The financial landscape of the corporate sector has been varying across three categories depending on the progress in restructuring. The *chaebols* have experienced a substantial decrease in operating earnings mainly due to a combined effect of sharp fall in sales revenue and the capital loss related to exchange rate depreciation. This was particularly so for the top 6-70 *chaebols*. Despite the debt reduction to some degree as can be seen in Figure II-3, the debt servicing capacity of the *chaebols* deteriorated significantly after the crisis. The IPCRs of the top 5 *chaebols* declined to 0.94 in 1998, down from 1.60 in 1997. The decline in the IPCR is most pronounced in the top 6-70 *chaebols* as it fell to 0.43 from 0.95 in just a year. In contrast, the IPCRs of non-*chaebol* independent corporations slightly rose to 1.31 in 1998. In fact, non-*chaebol* companies and the *chaebols* are showing a different pattern in terms of the ratio of EBITDA over total assets as can be seen in Figure II-2.

However, the corporate sector as a whole suffered from unprecedented economic setback after the crisis, as clearly illustrated in Figure II-4. Despite debt reduction and restructuring, ROAs turned out to be negative for all categories. The main factor behind such poor ROAs was the high interest rates and large losses from exchange rate depreciation, among others.

## <Figure II-1> Interest Payment Coverage Ratios

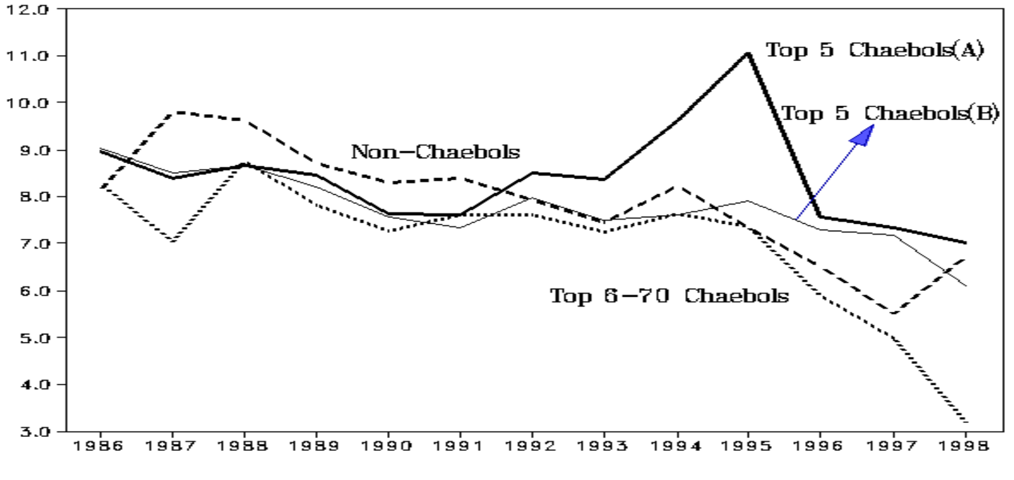
(Unit: times)




Note: 1) (A) includes all subsidiaries of the top 5 *chaebols*, (B) excludes semiconductor-producing companies among the top 5 *chaebols*,
Data Source: National Information and Credit Evaluation Inc.

## <Figure II-2> EBITDA/Total Assets

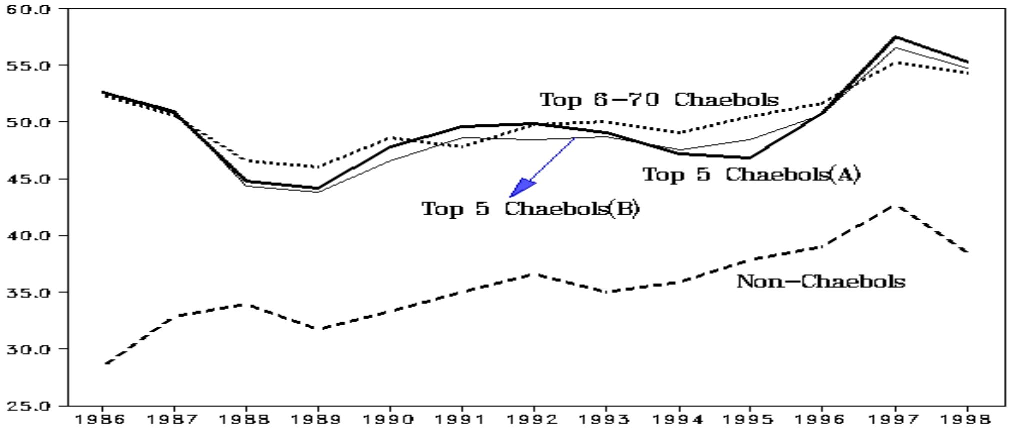
(Unit: %)




Note: 1) (A) includes all subsidiaries of the top 5 *chaebols*, (B) excludes semiconductor-producing companies among the top 5 *chaebols*,
Data Source: National Information and Credit Evaluation Inc.

**<Figure II-3> Total Borrowings to Total Assets**

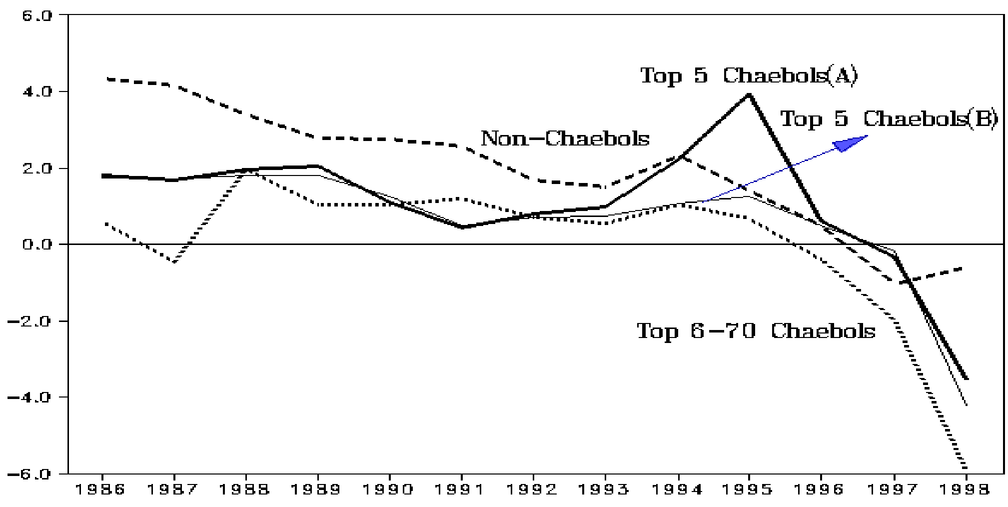
(Unit: %)




Note: 1) (A) includes all subsidiaries of the top 5 *chaebols*, (B) excludes semiconductor-producing companies among the top 5 *chaebols*,
Data Source: National Information and Credit Evaluation Inc.

**<Figure II-4> Return on Assets (ROAs)**

(Unit: %)




Note: 1) (A) includes all subsidiaries of the top 5 *chaebols*, (B) excludes semiconductor-producing companies among the top 5 *chaebols*,
Data Source: National Information and Credit Evaluation Inc.

Table II-4 provides more detailed information on the significance of financial trouble in the corporate sector before and after the financial crisis in terms of IPCRs. Given the definition of the IPCR, the loans extended to firms with IPCRs of less than 1 are regarded as potential NPLs. Under this premise, signs of financial trouble have already existed in 1994 both in terms of business performance and financial soundness. The amount of borrowing of firms with IPCRs of less than 1 already reached to 29 trillion won in 1994, accounting for 19% of total borrowings of all sample firms. Also, the number of such firms exceeded 1,000 or 20% of total firms included in the sample. The amount of potential NPLs further increased to 32 trillion won in 1995 despite the fact that the economy was in boom. In 1998, potential NPLs jumped to 113 trillion, which is 3.9 times as high as the figures in 1994, largely due to a drastic rise in interest rates and sharp reduction in profitability. This situation is particularly pressing for the top 6-70 *chaebols.*

At this juncture, it should be noted that factor costs have stabilized considerably since the second half of 1998: not only have interest rates dropped significantly, but nominal wages have also fallen as firms struggled to survive and workers preferred pay cuts to reductions in employment. The decline in factor costs significantly improved firms' balance sheets and IPCRs in 1999. With these developments, corporate default risks were perceived to decrease, while the credit crunch was significantly mitigated. Nonetheless, as evidenced by the fall of Daewoo in June 1999 and associated financial market volatility, the still heavy debt service burden of the *chaebols* continued to pose systemic risks to the financial market.

**<Table II-4> Deteriorating Corporate Performance**

(Unit: number of firms, trillion won)

| | | Interest Payment Coverage Ratio | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 1994 | | 1995 | | 1996 | | 1997 | | 1998 | |
| | | ≥ 1 | <1 | ≥ 1 | <1 | ≥ 1 | < 1 | ≥ 1 | < 1 | ≥ 1 | <1 |
| Top 5 *Chaebols* | Number Of firms | 128 | 23 (15%) | 128 | 27 (17%) | 126 | 29 (19%) | 119 | 43 (27%) | 111 | 38 (26%) |
| | Borrowings | 52 | 8 (13%) | 71 | 6 (8%) | 88 | 11 (11%) | 139 | 19 (12%) | 142 | 24 (14%) |
| Top 6~70 *Chaebols* | Number Of firms | 292 | 110 (27%) | 322 | 121 (27%) | 298 | 153 (34%) | 238 | 182 (39%) | 233 | 196 (46%) |
| | Borrowings | 38 | 8 (17%) | 48 | 9 (16%) | 52 | 19 (27%) | 65 | 31 (32%) | 44 | 52 (54%) |
| Non-*Chaebols* | Number Of firms | 3,652 | 905 (20%) | 3,811 | 1,246 (25%) | 3,632 | 1,418 (28%) | 3,757 | 1,758 (32%) | 3,898 | 1,640 (30%) |
| | Borrowings | 36 | 12 (25%) | 45 | 17 (27%) | 50 | 23 (32%) | 55 | 35 (39%) | 56 | 37 (40%) |
| Total | Number Of firms | 4,072 | 1,038 (20%) | 4,261 | 1,394 (25%) | 4,056 | 1,600 (28%) | 4,159 | 1,983 (32%) | 4,242 | 1,874 (31%) |
| | Borrowings | 126 | 29 (19%) | 164 | 32 (16%) | 190 | 52 (21%) | 259 | 85 (25%) | 242 | 113 (32%) |

Note: Figures in parenthesis indicate the share of firms and total borrowings in each categorized group.
Data Source: National Information and Credit Evaluation Inc.

## 3. Distorted Linkage between the *Chaebols* and Financial Sector

With respect to *chaebols*' unsustainably high debt leverage, key questions are; 1) how could *chaebols* borrow to the point of unthinkable leverage before the financial crisis in the first place, and 2) how could *chaebols* survive for several years with such heavy burden of debt at the time of economic downturn? These two questions are inter-related issues. Answers to both of these questions critically hinge upon poor internal governance of both corporate and financial sectors, as well as lax financial supervision.

### (1) Interest Rate Control and Policy Loans

Interest rate control combined with massive provision of policy loans to targeted sectors encouraged the *chaebols* to rely more on borrowings than equity financing. In particular, the so-called heavy and chemical industry (HCI) drive in the 1970s and the continued provision of policy loans until the mid-1980s resulted in large debt exposure of the *chaebols* as they are the major recipients of such a financial support.

Since the early 1960s, the Korean government has played a pervasive role in financing industrial development.[1] The Korean government directly owned all major banks in 1961, directed policy loans to priority sectors such as exporting sector and HCIs. Policy loans have indeed been substantial during the HCI drive in the 1970s: they constituted about 50 percent of total domestic credit (Table II-5). The state influence over the banking sector has waned along with the progress in financial liberalization, particularly the privatization of commercial banks. Nonetheless, it has remained substantial until recently. In fact, the share of policy loans in total loans extended by deposit money banks (DMBs) remained about 60 percent in 1987~91.

[1] J.K. Kim (1993), and J.K. Kim et al.(1993), Y.J. Cho and J.K. Kim (1995) provide more details on the directed credit programs in Korea.

**<Table II-5> Share of Policy Loans by DMBs and NBFIs**

(Unit: %)

| | 1973~81 | 1982~86 | 1987~91 | Average during entire period 1973~91 |
|---|---|---|---|---|
| DMB loans (A) | | | | |
| Government funds | 7.5 | 7.4 | 8.0 | 7.6 |
| National Investment Fund | 4.3* | 5.1 | 3.0 | 4.2 |
| Foreign currency loans | 21.1 | 19.7 | 19.4 | 20.3 |
| Export loans | 21.3 | 16.9 | 5.2 | 16.2 |
| Commercial bills discounted | 8.0 | 13.9 | 16.5 | 11.6 |
| Special funds for SMCs | 5.9 | 5.6 | 6.5 | 6.0 |
| Loans for AFL | 6.1 | 5.3 | 7.4 | 6.2 |
| Housing loans | 8.0 | 13.1 | 14.1 | 10.8 |
| Other[1)] | 17.7 | 13.1 | 20.0 | 17.1 |
| Policy Loans Total | 100.0 | 100.0 | 100.0 | 100.0 |
| NBFI loans (B) | | | | |
| KDB loans | 91.9 | 71.7 | 83.7 | 84.8 |
| (National Investment Fund) | (25.7)* | (18.5) | (7.9) | (19.5) |
| EXIM loans | 8.1 | 28.3 | 16.3 | 15.2 |
| (National Investment Fund) | ( 2.5)* | (4.7) | (2.3) | ( 3.0) |
| Policy Loans Total | 100.0 | 100.0 | 100.0 | 100.0 |
| (A)/DMB loans | 63.0 | 59.4 | 59.5 | 61.2 |
| (B)/NBFI loans | 48.0 | 32.3 | 15.3 | 35.9 |
| ((A) + (B))/domestic credit | 48.9 | 40.8 | 30.9 | 42.4 |

Notes : Figures in the table are annual averages.

* Annual average during 1974~81.

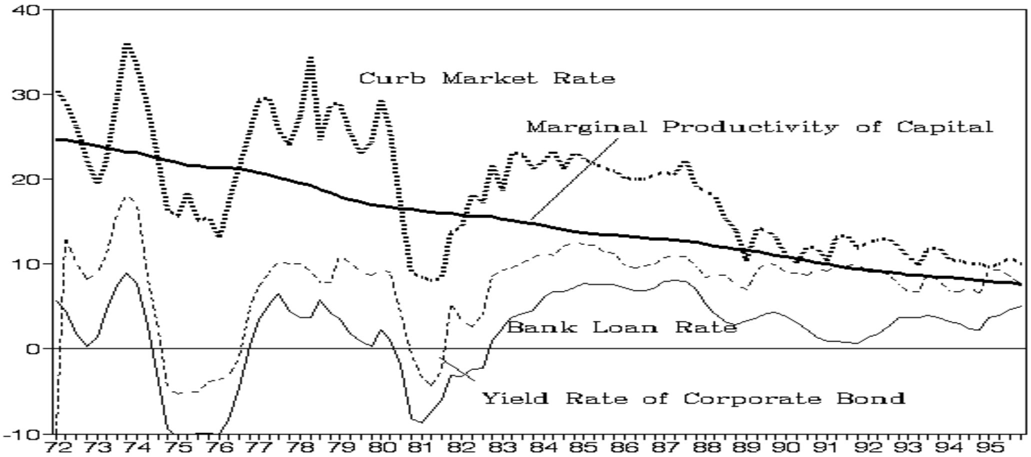
1) Includes loans for imports of key raw materials, loans on mutual installment, loans for machinery, equipment loans to the export industry, special equipment funds, and special long-term loans.

*Source* : National Statistical Office, *Korean Economic Indicators*, various issues: Bank of Korea, *Monthly Bulletin*, various issues. Quoted from Y.J. Cho and J.K. Kim(1995).

Interest rate deregulation had not been extensively implemented until recently because of the fear on a sharp increase in interest costs in the face of high debt leverage. Under this circumstance, banks had little incentive for credit evaluation. Since real interest rates have remained below the marginal productivity of capital as shown in Figure II-5, over-borrowing has taken place, and the subsequent increases in financial expenses induced further borrowing. Such a vicious cycle ultimately led to an unbearably high leverage and reckless capacity expansion in the corporate sector.

**<Figure II-5> Real Interest Rate and Marginal Productivity of Capital[1)]**

(Unit: %)




Note: 1) We estimate the marginal product to capital using the Cobb-Douglas production function approach in Cho and Oh (1996). We assume a capital-output ratio of output ratio of 1/3 and depreciation rate of 0.065. We also estimate the potential GDP and capital stock derived from the KDI quarterly model.

### (2) Government-led Bailout Policy: Too-Big-To-Fail

The provision of policy loans and the interest rate control have contributed to investment resource mobilization and rapid industrialization. At the same time, however, such a policy resulted in heavy corporate leverage, particularly for the *chaebols*, as well as the retardation of the banking industry in terms of risk management and credit evaluation. The debt-ridden *chaebols* became vulnerable to business fluctuations, and the corporate failure posed systemic risks at the time of recession. Given the tight linkage between the banking and corporate sector, corporate failures had an immediate impact on the soundness and viability of banks.

For these reasons, the government undertook major corporate bailout exercises in numerous occasions, including the August 1972 Emergency Measure, industrial restructuring in major HCIs (1979~81) and industrial rationalization measures in depressed industries such as overseas construction and shipping industries (1984~88).[2] The government also provided financial support to creditor banks in order to prevent systemic risks.

2 J.K. Kim (1991), Y.J. Cho and J.K. Kim (1995), and K.S. Kim and J.K. Kim (1997) provide more details on the bailout policies in the past.

The first and prime example of corporate bailout by the government is the August 1972 Emergency Measure that included not only corporate debt rescheduling by creditor banks but also a temporary moratorium on the payments of corporate debt owed to curb market lenders (Box 1). Such a measure was deemed inevitable at that time in the face of unbearable default risk of the corporate sector stemming from high leverage. In addition, it signaled to private firms the government's implicit commitment to become a risk-sharing partner with them. Indeed, since then, Korean entrepreneurs were able to undertake risky ventures and attach a long-term perspective to their investment decisions.

As the August 1972 Measure set the precedent for corporate bailout, similar rescue operations by the government followed in several occasions.[3] Such recurrent government bailouts, however, were not free of costs. The government bailouts exacerbated the already weak market discipline and caused serious moral hazard problems. Excessive corporate leverage based on implicit risk-sharing by the government created the so-called "too-big-to-fail" hypothesis, which worked as an important exit barrier and often overshadowed the voices for financial market liberalization. Given the preponderance of the *chaebols'* market share and the vertically integrated industrial structure, the social costs of the *chaebol* bankruptcy would be enormous. In such an environment, the *chaebols'* incentive structure with regard to corporate financing was seriously distorted: the more *chaebols* borrow, the safer *chaebols* are. Given the implicit state guarantees on bank lending, banks had little incentive to monitor the client firms' investment decision. Strict prudential regulation and supervision were hardly applied to banks given the fact that the government and banks were in the same boat in the sense that both acted as a risk-sharing partner of business firms. Indeed, in the course of a bailout, management of a rescued financial institution and corporation was not replaced, further undermining incentives for prudent behavior.

[3] Following upon the August 1972 Measure, the government introduced various measures geared to reduce debt leverage and improve governance through tightened credit control on *chaebols* and incentives for public offering of firms. These measures, however, turned out to have only limited results as the HCI drive was initiated since 1974 with the provision of massive financial support.

**<Box 1> August 1972 Emergency Measure**

High economic growth after the first five-year economic plan period (1962~66) made Korean industrialists optimistic about the future of the economy. Their optimism combined with rapid growth of domestic credit and increase in foreign borrowing fueled the investment boom of the second half of the 1960s. During 1963~71, the debt/equity ratio of the manufacturing sector increased by more than four times, from 92 percent to 394 percent.

As the economy showed signs of over-expansion with a swelling current account deficit in the late 1960s, the IMF stepped in. The IMF recommended the currency devaluation, abolition of export subsidies and tight monetary control (an orthodox IMF program). The Korean government did not accept these recommendations, which could thwart the second five-year economic plan and jeopardize rapid growth. But the pressure was intense: the US made the consideration of additional PL 480 and developmental loan funding conditional on the acceptance of the IMF program. The government then agreed to the IMF program in 1970, with the exception of the demand to end export subsidies — the incentive that the government viewed as the pillar of its export-led growth strategy. Consequently, monetary expansion dropped and economic growth also fell from 13.8 percent in 1969 to 7.6 percent in 1970. This drop was followed by a currency devaluation of 18 percent in 1971.

Devaluation and tight credit control hit domestic firms hard, especially those that borrowed from abroad. The world economic recession made things worse. The net profit ratio of the manufacturing sector fell sharply and NPLs in the bank started to pile up. Under tight credit control, domestic banks could not help firms finance the increased foreign loan payments. Business turned to the last available resort: the curb market. By 1971, the number of bankrupt enterprises that had received foreign loans climbed to 200 which was more than 50% of total firms, Korea faced the first debt crisis.

Business was in an uproar. The Korean Federation of Industrialists urged immediate remedies – something short of declaring national bankruptcy to the international financial community to bail out firms. The government originally considered mobilizing the special funds of ten billion won (about 3.3 percent of the total money supply). Business responded that the amount was far short of what was required. After consultation with leading businessmen, the government concluded that some extraordinary measures were necessary to cushion the financial burden of the debt-ridden firms, and eventually issued its Emergency Decree in August 1972.

It included an immediate moratorium on the payment of all corporate debt to the curb lenders and extensive rescheduling of bank loans. All corporate loans from the curb market were converted to long-term loans, at a maximum interest rate of 16.2 percent, when the prevailing curb-market rate was over 40 percent per annum. About 30 percent of the short-term bank loans to business were converted into long-term loans at a reduced interest rate. This conversion was ultimately backed by the central bank, which accepted the special debentures issued by the commercial banks (C.Y. Kim 1990 and 1994, and Y.J. Cho and J.K. Kim 1995).

Such bail-out policy worked as an exit barrier for *chaebols,* fostering the false hypothesis of too-big-to-fail. It also induced banks to rely on implicit guarantees by the government in making loan decisions. The result was a vicious cycle of reckless lending and investment and pervasive moral hazard problems.

### (3) *Chaebols*' Ownership of Financial Institutions, Poor Governance and Lax Prudential Regulation

Ownership structure of financial institutions is a critical element in the fabric of corporate governance as it is directly related to the issue of conflict of interests. Strong governance usually emerges in response to predictable pressures from shareholders, supervisors and market competition.

In Korea, the social concern about the strong economic influence of *chaebols* translated into strict restrictions on the bank ownership structure. Upon the liberation in 1945, the Korean government took over Japanese owned banks. After long U.S. pressure, the government sold its shares commercial banks to private sector in 1957. As a result, Lee Byung-Chul in Samsung Group, Chung Jae-Ho in Samho Group and Lee Han-Won in Daehan Jeboon were able to control over 83% of total shares of Heungop Bank (former Hanil Bank), 51% of Savings Bank (former Korea First Bank) and 29% of Korea Commercial Bank, respectively. Unfortunately, the takeover of banks by a few large industrialists was soon accompanied by worrisome consequences, particularly the concentration of bank credits for their own use. For the next few decades, such undesirable side effects of bank privatization provided a strong social justification for government control over banks. Indeed, major Korean banks were nationalized in 1961 when the new government was established by a military coupe.

In 1982, when the privatization of the banking sector was pursued, a ceiling of 8% was imposed on individual ownership of nationwide commercial banks, in order to prevent any single shareholder from exerting excessive influence and control of a bank's management. This restriction was further strengthened as the ceiling was lowered to 4% in 1994 in line with the progress in financial liberalization. Despite this restriction, the ownership distribution of Korean banks is no less concentrated than in the case of advanced countries such as the United States. As of the end of 1996, the combined shares of those who own more than 1% of the total voting stocks of nationwide banks accounted for 39.3% on average, as shown in Table II-6. For local banks whose ownership structure is much more concentrated than nationwide banks due to a higher ceiling, combined shares of large shareholders over 1% is 49.7%. Also, among large shareholders top 30 *chaebols* are predominant as can be seen in Table II-7.

**<Table II-6> Large Shareholders' Ownership of Banks**

(As of the end of 1996)

| Classification | Large Shareholders Over 1% | | Large Shareholders Over 4% | | Ownership Share by 5 Largest Shareholders (%) (by 3 largest Industrial Capital ) |
|---|---|---|---|---|---|
| | Number | Ownership Share (%) | Number | Ownership Share (%) | |
| Chohung | 11(4) | 45.7(14.7) | 5(2) | 32.4 (10.0) | 32.4(12.8) |
| Commercial | 10(3) | 35.1( 9.3) | 5(1) | 27.4 ( 7.0) | 27.4( 9.3) |
| Korea First | 13(5) | 35.6(15.7) | 2(1) | 12.5 ( 5.5) | 22.4(12.5) |
| Hanil | 14(5) | 45.5(15.8) | 4(1) | 20.8 ( 4.8) | 24.6(11.4) |
| Seoul | 12(6) | 30.6(14.2) | 2(1) | 12.0 ( 4.6) | 20.3(10.3) |
| 5 Largest Nationwide Banks, Average | 12(5) | 38.7(13.9) | 4(1) | 21.3(6.5) | 25.6 |
| Korea Exchange | 9(2) | 59.0( 2.1) | 1(-) | 47.9(-) | 54.6(n.a.) |
| Kookmin | 9(1) | 48.5( 2.0) | 3(-) | 37.2(-) | 43.4(n.a.) |
| Shinhan | 6(2) | 16.4( 4.5) | - (-) | - (-) | 15.3(n.a.) |
| KorAm | 9(6) | 70.4(45.6) | 5(3) | 64.4 (41.1) | 79.9(41.1) |
| Hana | 16(5) | 54.6(19.4) | 5(2) | 28.5 (11.0) | 28.5(14.5) |
| Boram | 17(5) | 52.9(26.0) | 5(3) | 31.4 (20.8) | 31.4(20.8) |
| Donghwa | 10(2) | 14.9( 2.3) | - (-) | - (-) | 8.7(n.a.) |
| Daedong | 3(-) | 17.1(-) | 2(-) | 15.2 (-) | n.a.(n.a.) |
| Dongnam | 7(-) | 20.0(-) | 2(-) | 13.8 (-) | 17.8(n.a.) |
| Peace | 9(1) | 49.0( 1.3) | 6(-) | 42.2 (-) | 37.0(n.a.) |
| Nationwide Banks, Average | 10(2) | 39.3(10.7) | 3(1) | 24.3(5.4) | - |
| Daegu | 15(3) | 40.6( 8.6) | 4(1) | 22.9(5.7) | 25.6( 8.6) |
| Pusan | 14(3) | 52.0(28.8) | 2(1) | 31.8(23.9) | 40.4(28.8) |
| Chungchong | 14(5) | 63.9(27.7) | 3(1) | 36.2(16.5) | 43.0(23.3) |
| Kwangju | 13(2) | 41.7( 9.5) | 3(1) | 21.7(7.9) | 28.6( n.a.) |
| Cheju | 10(4) | 51.8(31.7) | 3(1) | 36.6(26.5) | 42.1(30.6) |
| Kyonggi | 13(5) | 42.6(20.6) | 3(2) | 21.6(14.3) | 28.7(17.7) |
| Jeonbook | 15(4) | 59.4(24.3) | 6(3) | 41.8(23.1) | 37.3(23.1) |
| Kangwon | 17(3) | 57.0(14.5) | 4(1) | 31.2(11.9) | 34.9(14.5) |
| Kyungnam | 16(4) | 50.4(20.5) | 2(1) | 19.4(11.6) | 29.7(18.2) |
| Chungbuk | 16(5) | 54.1(11.3) | 4(1) | 29.7(4.7) | 33.4( 9.3) |
| Local Banks, Average | 14(4) | 49.7(18.5) | 3(1) | 27.6(13.5) | 33.0 |
| Commercial Banks, Average | 12(3) | 40.9(11.9) | 3(1) | 24.8(6.6) | - |

Note : Figures in parenthesis indicate the number and ownership share by private industrial capital (including affiliated financial institutions).
*Source* : The Bank Supervisory Board.

### <Table II-7> Share of Banks Owned by Top 30 *Chaebols*

(As of the end of 1996, Unit: %)

| Conglomerates | Ownership Share |
|---|---|
| 1. Hyundai | Korea First bank(2.20), Hanil bank(2.00), Seoul bank(1.99), Kangwon bank(11.89) |
| 2. Samsung | Chohung bank(2.81), Commercial bank(7.03), Korea First bank(3.96), Hanil bank(4.76), Seoul bank(3.77), Korea exchange bank(1.05), Shinhan bank(3.36), KorAm bank(18.56), Hana bank(3.42), Peace bank(1.28), Daegu bank(5.65), Pusan bank(1.02), Kyonggi bank(1.57), Jeonbook bank(1.20), Kangwon bank(1.22), Kyung nam bank(2.38) |
| 3. LG | Korea First bank(3.03), Hanil bank(2.47), Boram bank(7.58), Cheju bank(1.80) |
| 4. Daewoo | KorAm bank(18.56) |
| 5. SK | Kyonggi bank(3.42) |
| 6. Ssangyong | Chohung bank(1.98), Korea exchang bank(1.04), Hana bank(1.52), Kookmin bank(1.96) |
| 7. Hanjin | Kyonggi bank(5.63) |
| 8. Kia | Korea First bank(1.04) |
| 9. Hanwha | Chungchong bank(16.49) |
| 10. Lotte | Pusan bank(23.93) |
| 11. Kumho | Kwangju bank(7.87) |
| 12. Doosan | Boram bank(11.34) |
| 13. Daelim | Hanil bank(3.57) |
| 14. Hanbo | |
| 15. DongAh | Seoul bank(1.50), Cheju bank(2.31) |
| 16. Halla | |
| 17. Hyosung | Hana bank(5.16), Kyungnam bank(11.57) |
| 18. Dongkuk Steel | Seoul bank(1.27), Pusan bank(3.85), Kyungnam bank(3.92) |
| 19. Jinro | Hana bank(3.51) |
| 20. Kolon | Boram bank(5.80) |
| 21. Tongyang | Donghwa bank(1.03) |
| 22. Hansol | |
| 23. Dongbu | Cheju bank(1.06), Chungbuk bank(1.74) |
| 24. Kohab | |
| 25. Haitai | |
| 26. Sammi | |
| 27. Hanil | |
| 28. Kukdong-Construction | |
| 29. New Core | |
| 30. Byucksan | |

*Source*: The Bank Supervisory Board

Despite the bank ownership structure comparable to that of advanced countries, large shareholders of most banks have remained passive in exercising their voting rights and monitoring bank management. Government intervention in the appointment of CEOs of banks has prevented bank management from pursuing shareholders' interests. To make matters worse, the board of directors of banks has not been in a position to check the management in an independent manner. Typically, the nomination of directors is in control of inside management. Although there existed a certain number of non-executive directors in case of large nationwide banks, they were not assigned a clearly defined role, nor provided with necessary information for monitoring. Accordingly, internal governance of banks remained ineffective and poor.

Unlike banks, non-bank financial institutions (NBFIs) were free of ownership restrictions except life insurance companies and investment trust companies (ITCs).[4] As a result, many NBFIs are currently owned or actually controlled by *chaebols* (Table II-8). As of 1997, the 70 largest *chaebols* owned a total of 114 financial affiliates – an average of five financial affiliates in the case of the 5 largest *chaebols* -- concentrated in securities companies, merchant banking companies (MBCs), non-life insurance firms, and installment credit companies.

Although many NBFIs are owned by large industrial groups, financial supervision on NBFIs has been lax as can be seen from the fact that basic prudential regulations such as capital adequacy requirements were absent until the onset of the crisis. The principal regulator and supervisor of NBFIs has been the Ministry of Finance and Economy (MOFE). However, only a small working-level unit has been assigned the supervisory role within the MOFE, making an effective monitoring almost impossible. In short, the NBFIs have been under the strong influence of chaebols while the government supervision was almost absent. Such combination was a disaster in waiting as can be seen from the fact that the financial trouble of MBCs acted as a triggering point for the financial crisis in 1997.

[4] For life-insurance companies, 5 largest conglomerates were prohibited from newly entering the market and 6-10 largest conglomerates were allowed to hold only less than 50% of the equity since 1996. The restrictions were repealed in February 1997, except the condition that 5 largest conglomerates wishing to enter the market should acquire 1-2 unsound institutions. For investment trust companies, 30 largest conglomerates cannot own more than 15% (30% for local trust companies). But this ownership restriction was lifted in 1998.

**<Table II-8> Number of NBFIs Owned by Top 70 *Chaebols*[1)]**

(Unit: number of firms, the end of 1997)

| | Top 5 *Chaebols* | Top 6-30 *Chaebols* | Top 31-70 *Chaebols* | Total |
|---|---|---|---|---|
| Merchant Bank (29)[2)] | 3 | 7 | 4 | 14 |
| Securities (26) | 6 | 5 | 1 | 12 |
| Investment Trust (24) | 4 | 6 | 0 | 10 |
| Life Insurance (31) | 2 | 4 | 8 | 14 |
| Fire & Marine Insurance(13) | 2 | 3 | 0 | 5 |
| Installment Credit (26) | 2 | 7 | 3 | 12 |
| Mutual Saving & Finance (219) | 1 | 5 | 12 | 18 |
| Venture Capital (56) | 3 | 4 | 6 | 13 |
| Credit Card (7) | 3 | 1 | 0 | 4 |
| Finance & Factoring (46) | 3 | 4 | 5 | 12 |
| Total (487)[3)] | 29 | 46 | 39 | 114 |

Note: 1) The rank of *chaebols* is based on total borrowings.
2) The figure in the parentheses represents the total number of financial institutions at each financial sector.
3) Leasing companies are excluded as they are owned by banks.
Data Source: National Information and Credit Evaluation Inc.

## 4. Policy Responses to the Crisis

Given the fact that Korea's financial crisis was the combined results of structural defects in financial and corporate sectors, the crisis resolution had to address reform in both sectors, not to mention macroeconomic policy responses.

At the risk of oversimplification, there are three major policy agenda regarding Korea's structural reform; 1) corporate sector restructuring, 2) corporate governance reform and 3) financial sector restructuring. Korea's post-crisis reform drive has dealt with these three policy agenda almost simultaneously as they are inseparably linked with each other.

Corporate restructuring has focused on *chaebol* restructuring with due consideration on debt reduction and business restructuring. To this end, the new administration and business leaders agreed on the 200% debt-equity ratio target to be achieved by the end of 1999 as well as the elimination of cross-debt guarantees by March 2000. Business restructuring has progressed in a variety of ways including spin-offs, business mergers and swaps.

Corporate governance reform was swiftly implemented with major emphasis on transparency, accountability and information disclosure. Listed firms were required to appoint outside directors while the scope and the responsibility of directors were expanded. At the same time, various protection measures for minority shareholders were further strengthened. Last but not the least, *chaebols* were required to produce combined financial statements.

Financial sector restructuring has placed first priority on the liquidation of insolvent banks, the resolution of NPLs and the recapitalization of viable banks. To this end, the government mobilized fiscal resources to support the disposal of NPLs and the rehabilitation of troubled but viable banks. At the same time, the supervisory authority applied prompt corrective actions (PCAs) to financial institutions and introduced stricter loan classification standards using forward looking criteria on par with international standards.

One notable feature of post-crisis corporate restructuring is that in contrast to the past, it has been implemented within an institutional framework. In the absence of a well-developed capital market, creditor banks were needed to play a catalytic role in corporate sector restructuring, particularly, *chaebol* restructuring. Corporate workout programs for medium-sized *chaebol*s and debt reduction of large *chaebol*s have all been pushed and monitored by financial institutions, particularly creditor banks. To enable banks to take initiative, banking sector restructuring was the first task in sequencing post-crisis reform measure. Another important policy in supportive of both financial and corporate restructuring was the dramatic liberalization of capital market. Specifically, restrictions on foreign equity ownership and portfolio investment in short-term money market were completely lifted, while hostile M&As by foreigners were fully liberalized.

## III. Corporate Sector Restructuring: Progress and Assessment

Corporate restructuring has been one of the key policy issues in Korea since the onset of the crisis. As is well known, a string of bankruptcies of the *chaebol* affiliates in early 1997, starting from Hanbo Steel Co., was the prelude of Korea's financial crisis. Also, the highly leveraged expansion of the *chaebols* and their reckless investment have been at the core of intrinsic vulnerability of the Korean economy, both financially and macroeconomically. By the same token, a genuine economic recovery cannot be achieved unless the corporate sector, particularly the *chaebols*, is fully equipped with sound capital and governance structure.

During the past two years or so, Korea's corporate sector has made significant progress in terms of soundness and efficiency. However, corporate restructuring and governance reform in Korea is an ongoing process, and in fact, there are more challenges to overcome than what has been achieved. In light of this, it is critical to assess the interim progress and draw lessons from it.

### 1. Restructuring Measures and Progress

#### (1) De-leveraging of the *Chaebols*

Corporate restructuring has focused on de-leveraging of the c*haebols* whose average debt-equity ratio peaked at 519% (top 30 c*haebols*) at the end of 1997. The new administration and the business leaders agreed on the 200% debt-equity ratio target to be achieved by the end of 1999. Also, they agreed on the elimination of cross debt guarantees by March 2000. In order to ensure tangible progress, corporations are required to submit blueprints of their restructuring plans to the Financial Supervisory Commission (FSC). If the c*haebols* do not comply, they are subject to financial constraints such as withdrawals of existing loans and denied access to new loans. Such penalty measures have also been agreed to in principle by the c*haebols* and their main banks.

Over the past two years or so, Korea's corporate restructuring has produced tangible progress. The top 4 c*haebols* (Hyundai, Samsung, LG and SK) reduced their average debt-equity ratio to 302% by mid-1999. Given the rapid economic recovery since the second half of 1999 and a resultant increase in corporate profits, the debt-equity ratios of these c*haebols* are expected to further decline. Indeed, as of the end of 1999, a preliminary estimate for the average debt-equity ratio of the top 4 c*haebols* turned out to be about 180%, far below the agreed 200% target. In addition, by the third quarter of 1999, the top 4 c*haebols* have raised funds worth 26.8 trillion (or US$ 22.5 billion equivalent) in domestic market through equity issues and the sales of non-core businesses, as well as foreign capital worth of US$ 6.2 billion. (Korea's Crisis Resolution & Its Policy Implications, Ministry of Finance and Economy, 1999)

Cross-debt guarantees have also declined dramatically as shown in Table III-1. For the top 30 c*haebols*, the total outstanding balance of cross-debt guarantees reduced to 4.3 trillion won by the end of 1999, down from 33.6 trillion in April 1997. Top 5 c*haebols* (top 4 c*haebols* plus Daewoo Group) have come close to the complete elimination of cross-debt guarantees as their remaining balance is a mere 0.9 trillion won. Given these figures, most c*haebols*, except for some medium-sized c*haebols* whose core affiliates have been subject to corporate workout programs, will be able to completely eliminate cross-debt guarantees by March 2000 as initially agreed.

**<Table III-1> Cross-Debt Guarantees**

(Unit: trillions won)

| | Apr. 1997 | Apr. 1998 | Apr. 1994 | Dec. 1999 |
|---|---|---|---|---|
| Top 5 c*haebols* | 11.8 | 11.1 | 2.3 | 0.9 |
| Top 6~30 c*haebols* | 21.8 | 15.8 | 7.5 | 3.4 |
| Total | 33.6 | 26.9 | 9.8 | 4.3 |

Source: Korea Fair Trade Commission.

### (2) Business Restructuring of Large *Chaebols*

As a means of business restructuring, the large c*haebols* have also been strongly urged to focus on core businesses. To this end, large-scale business mergers and swaps, referred as “Big Deals” in Korea, have been pursued in several industries that were identified to have excess capacity: semiconductors, power-generating equipment, petro-chemicals, aircraft manufacturing, railroad vehicles, vessel engines, and oil refinery. As of the end of 1999, Big Deals were mostly completed through purchase and assumptions (P&As) or the establishment of a consolidated sole corporation, except for the petrochemical sector.

## <Table III-2> Big Deals Plan and Progress

| Business line | Plan of the Deal | Controlling Body |
|---|---|---|
| Semiconductors | Samsung Electronics Co. →<br>Hyundai Electronics Ind., LG Semiconductor Co. — M&A → | Samsung Electronics Co.<br>Hyundai Electronics Ind.<br>(Completed in July 1999) |
| Power-Generating Equipment | Hyundai Heavy Industries Co., Korea Heavy Industries & Construction Co., Samsung Heavy Industries Co. — M&A → | Korea Heavy Industries & Construction Co.<br>(Completed in December 1999) |
| Petro-Chemicals | SK, LG, Daelim, Lotte, Hanwha →<br>Hyundai Petro-chemical Co., Samsung General Chemical Co. — M&A → | SK, LG, Daelim, Lotte, Hanwha<br>Sole corporation establishment |
| Aircraft Manufacturing | Korea Air Line Co. →<br>Samsung Aerospace Industries Co., Daewoo Heavy Industries Co., Hyundai Space & Aircraft Co. — M&A → | Korea Air Line Co.<br>Sole corporation establishment<br>(Completed in October 1999) |
| Railroad Vehicles | Hyundai Precision & Ind. Co., Daewoo Heavy Industries Co., Hanjin Heavy Industries Co. — M&A → | Sole corporation establishment<br>(Completed in July 1999) |
| Vessel Engines | Hyundai Heavy Industries Co. →<br>Korea Heavy Industries & Construction Co., Samsung Heavy Industries Co. — M&A → | Hyundai Heavy Industries Co.<br>Korea Heavy Industries & Construction Co.<br>(Completed in December 1999) |
| Oil Refinery | SK, LG, Ssangyong →<br>Hyundai Oil Co., Hanwha Energy Co — M&A → | SK, LG, Ssangyoung<br>Hyundai Oil Co.<br>(Completed in June 1999) |

Note: On December 7, 1998, the swap between Samsung Motors and Daewoo Electronics was announced as an Additional Big Deal plan.
*Source*: Financial Supervisory Commission. 1998. 12.

In addition to Big Deals, large c*haebols* were pushed to restructure their businesses in a variety of ways including spin-offs, corporate sales, and mergers. In fact, the government, creditor banks and the leaders of the top 5 c*haebols* agreed in December 1998 to reduce the number of their affiliates from 264 at the end of 1998 to about 130 by the end of 2000. In order to facilitate streamlining the business activities, the market for corporate control has been liberalized, allowing for even the hostile foreign takeovers. As a result, the number of subsidiaries and affiliates of the top 4 *chaebols* had declined to 165 by November 1999, down from 223 at the end of 1998.

### (3) Corporate Workout

On a separate track from formal insolvency mechanism, corporate workout programs were introduced in July 1998 in order to prevent a systemic corporate bankruptcy in the aftermath of the economic crisis and to facilitate an economic recovery. Except for Daewoo, most workouts have been applied to medium-sized c*haebols* and non-*chaebol* firms.

Korea's corporate workout programs are based on the ‘Corporate Restructuring Agreement’ signed by more than 200 financial institutions. If the creditors representing more than 75% of a firm’s financial obligations approve the debt restructuring plan, it becomes binding for all creditors. If the creditors cannot reach agreement, the main bank may request arbitration by the Corporate Restructuring Committee. The modality of debt restructuring includes debt-equity swaps, term extension, deferred payment of principal or interest, interest rate cuts and provision of new credits. Generally, workout program takes 5 years on average to be completed.

As shown in Table III-3, 102 firms in total were initially selected by main banks for potential candidate of workout programs. Among them, 8 companies were rejected and 15 companies were merged. For the remaining 79 firms, one company graduated from the workout program, and 78 companies (including 12 Daewoo affiliates) were under the workout procedure as of the end of 1999, where 77 companies had fixed their restructuring plans.

As of the end of 1999, the total amount of outstanding financial obligations of those 77 companies with fixed restructuring plan reached 104.9 trillion won, 71.2 trillion won out of which were accounted for by Daewoo’s obligation. Debt rescheduling measures have already been applied to non-Daewoo companies, covering 83% of their financial obligations of 33.7 trillion won by the end of 1999.

**<Table III-3> Corporate Workout Programs in Progress**

(As of the end of 1999, unit: number of companies)

| | Selected | Excluded | | | Plan fixed | Plan unfixed |
|---|---|---|---|---|---|---|
| | | Rejected[1] | Graduated | Merged | | |
| Daewoo Group | 12 | - | - | - | 12 | - |
| *Chaebol* Affiliates (top6~64 c*haebols*) | 47 | 5 | - | 12 | 29 | 1 |
| Non-*chaebol* Firms | 43 | 3 | 1 | 3 | 36 | - |
| Total | 102 | 8 | 1 | 15 | 77 | 1 |

Note: 1) 4 firms in Tongil Group 8 (Tongil Heavy Industry, Ilsung Construction, Ilshin Stone, Hankook Titanium Industry, Anam Electronics, Kyunggi Chemical, Daljay Chemical, Samhyup Development Co.).
*Source*: Corporate Restructuring Committee.

**<Table III-4> Debt Restructuring in Workout Programs**

(As of the end of 1999, unit: billion won)

| | Debt Restructuring[1] | | | | New Credits |
|---|---|---|---|---|---|
| | Repayment deferred | Debt/equity swap[2] | Others | Total | |
| Daewoo Group | 36,751 | 26,644 | 7,838 | 71,233 | 4,976 |
| *Chaebol* Affiliates (top 6~64 c*haebols*) | 21,310 (19,048) | 5,214 (1,976) | 1,838 (1,825) | 28,361 (22,848) | 1,247 (1,221) |
| Non-*chaebol* Firms | 4,367 (4,114) | 280 (240) | 668 (700) | 5,315 (5,054) | 545 (431) |
| Total | 62,428 | 32,138 | 10,344 | 104,910 | 6,768 |

Note: 1) Figures include debt guarantees of 12.1 trillion won (Daewoo 6.8 trillion won, non-Daewoo 5.3 trillion won).
2) Figures include the conversion of existing debt into convertible bonds.
3) Figures in the parentheses represent actual progress.
*Source*: Financial Supervisory Commission.

## 2. Assessment and Implications

Despite tangible progress, Korea's corporate restructuring is by no means complete. Moreover, the progress to date may not represent truly structural improvement in financial soundness and internal governance of Korea's corporate sector.

### (1) Slow Progress in Debt Reduction

First, the apparent improvement in the c*haebols'* debt-equity ratios is likely to overstate the true financial status of the c*haebols*. There are two major reasons for such suspicion. It should first be noted that the reported debt reduction figures of the *chaebols*, particularly the top 4 *chaebols*, seem to reflect in part the effect of window dressing. For instance, the top 4 *chaebols*' borrowings (bank loans plus CPs) decreased by 15.5 trillion won in December 1999, which is the deadline for meeting the 200% debt-equity ratio target. But the same figure rose by 8 trillion won in the next month. In fact, according to the Bank of Korea's Flow of Funds data, total indebtedness of the corporate sector, including trade credits, increased by 5.6 trillion won in 1999, from 801.5 trillion won at the end of 1998 to 807.1 trillion won by the end of 1999 (see Table II-1).

Another reason is the fact that the substantial portion of the improvement in debt-equity ratios was accounted for by increased inside equity ownership of the c*haebols* due to the so-called "circular investment". Circular investment across affiliates within the same *chaebol* tends to inflate equity capital in the book, and hence, help reduce debt-equity ratios with only a small amount of real capital injection. Therefore, the figures of *chaebol*'s leverage are likely to steep rise once the combined financial statements required for the *chaebols* are disclosed in July 2000.

Specifically, total equity investments by the top 30 *chaebol* affiliates in other firms, including the affiliates within the same *chaebol*, increased by 12.2 trillion won (from 17.7 trillion won in April 1998 to 29.9 trillion won in April 1999). Out of this total, 8.2 trillion won (or approximately two-thirds of the total) were accounted for by circular investment within each *chaebol*. As a result, in-group ownership of the top 30 c*haebols* increased from 44.5% in 1998 to 50.5% in 1999. Such a large increase in circular investment was made possible because the government lifted investment ceiling in February 1998. The rationale behind such deregulation was to help domestic firms defend managerial control from the hostile takeover by foreigners.

However, circular investment has been utilized by the c*haebols* as a means of not only meeting 200% debt-equity ratio target but also providing financial support to troubled affiliates. Furthermore, increased circular investment reinforced the managerial control power of the *chaebol* owners and their family. This aspect has an important implication for corporate governance as the right of minority shareholders could be at risk. Given this consideration, the Korea Fair Trade Commission (KFTC) reintroduced the ceiling (25% of net assets) on investment by the *chaebol* affiliates in other firms in December 1999. This regulation will be put into effect as of April 2000.

**<Table III-5> *Chaebols*' Equity Investment and In-group Ownership**

(Unit: trillion won, %)

| | Total Amount of Investment | In-group Ownership | | |
|---|---|---|---|---|
| | | Family Ownership | Shares of Subsidiaries | Total |
| 1998. 4 | 17.7 | 8.8 | 35.7 | 44.5 |
| 1999. 4 | 29.9 | 6.4 | 44.1 | 50.5 |

Source: Korea Fair Trade Commission

Second, not all c*haebols* have successfully restructured themselves. Daewoo Group is a prime example. Daewoo, once the second largest business group in Korea, had faced with serious financial trouble after the crisis, and become technically insolvent by June 1999. The fall of Daewoo created non-performing debt of about US$ 72 billion and has been posing systemic risks to the financial system, particularly to investment trust companies (ITCs) whose aggregate exposure accounted for about 45% of Daewoo’s total borrowing from financial institutions. Given the large magnitude of Daewoo’s non-performing debt, Korea’s corporate restructuring is by no means complete until the full resolution of Daewoo crisis.

Major creditor banks of Daewoo decided to apply workout programs to Daewoo, but the actual implementation of workout programs has not been easy given the large number of both domestic and foreign creditors and the conflict of interests among them. Only recently, the steering committee of foreign creditors accepted the debt resolution proposal made by domestic creditors. However, it is not yet clear whether foreign creditors will approve the proposal, and even if they do, it will take time to fully arrange debt resolution in detail.

Furthermore, it has been difficult to correctly identify the true significance of Daewoo's financial trouble due to the lack of transparent accounting information. Indeed, financial creditors of Daewoo and accounting firms had performed due diligence process two times, but their assessments on the financial aspect of Daewoo showed great difference over time. As of the end of 1999, the final report on Daewoo's financial status revealed that the net asset of 12 Daewoo affiliates combined, which were subject to workout programs, was as low as -29.2 trillion won, while Daewoo reported +14.1 trillion won for that figure in June 1999. This difference originated from inflated reporting on assets combined with deflated debt figures by Daewoo. Specifically, total asset of those 12 affiliates turned out to be 59.7 trillion won in the final report, which is far below the figure provided by Daewoo of 91.9 trillion won. The final figure for total debt was 89.0 trillion won, while Daewoo initially reported 77.8 trillion won for that figure.

**<Table III-6> Final Outcome of Due Diligence on Workout Firms of Daewoo Group**

(Unit: billion wons)

| | Preliminary Figures (June 1999)[1] | | | Final Figures (end-1999) | | |
|---|---|---|---|---|---|---|
| Daewoo Corporation | Assets (A) | Liabilities (B) | Net Assets (A-B) | Assets (A) | Liabilities (B) | Net Assets (A-B) |
| Daewoo Motors | 29,203 | 26,591 | 2,612 | 16,660 | 34,018 | -17,358 |
| Daewoo Heavy Industry | 20,646 | 15,560 | 5,086 | 11,835 | 17,911 | -6,076 |
| Daewoo Electronics | 13,794 | 10,661 | 3,133 | 12,028 | 11,009 | 1,019 |
| Daewoo Capital | 8,230 | 7,665 | 565 | 5,369 | 8,531 | -3,163 |
| Ssangyong Motors | 6,564 | 6,202 | 362 | 3,567 | 5,994 | -2,427 |
| Daewoo Telecom | 3,348 | 2,977 | 371 | 2,809 | 3,098 | -289 |
| Daewoo Motor Sales | 3,294 | 2,985 | 309 | 2,355 | 3,267 | -912 |
| Orion Electricity | 2,130 | 1,367 | 763 | 1,401 | 1,216 | 186 |
| Dinners Club Korea | 1,802 | 1,363 | 439 | 1,897 | 1,720 | 178 |
| Kyungnam Co. | 1,400 | 1,268 | 132 | 886 | 1,272 | -386 |
| Daewoo Electronics Parts Co. | 1,087 | 852 | 235 | 626 | 697 | -70 |
| Total | 395 | 276 | 119 | 365 | 293 | 72 |
| | 91,893 | 77,768 | 14,126 | 59,747 | 88,991 | -29,244 |

Note: 1) Figures for Daewoo Corporation, Daewoo Telecom, Dinners Club Korea, Ssangyong Motors are as of the end of August 1999. Figures for Daewoo Heavy Industry are as of the end of July 1999.

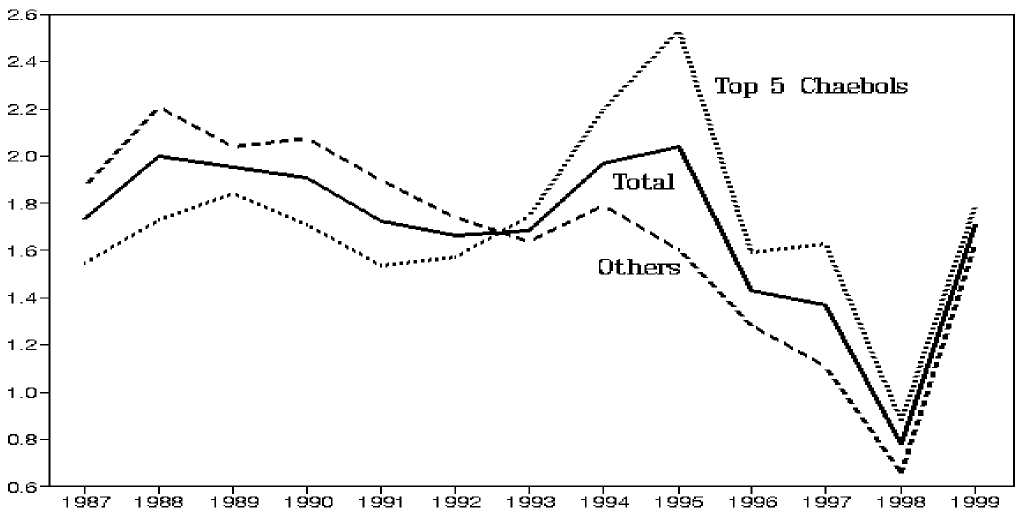
Source: Financial Supervisory Commission.

Third, financial de-leveraging of the c*haebols* is not satisfactory by international standards, as the corporate sector's debt servicing capacity still remains weak. As shown in Figure III-1, the interest payment coverage ratio (IPCR) of listed firms rose to 1.7 in the first half of 1999 from a mere 0.8 in 1998. The IPCR would rise further if the sample period were extended to cover the second half of 1999 when the economy moved into a full recovery phase. Given the fact that the Korean economy recovered rapidly in 1999 thanks to low interest rate policy and fiscal expansion, however, the substantial portion of such improvement in IPCR seems to be cyclical or temporary in nature, and hence is likely to shrink if the business cycle moves into a contraction phase in the future.

Moreover, the IPCR of around 2 is far below international standards. Figure III-2 shows that even before the crisis, the IPCRs of other Asian emerging economies were far higher than 2 while that of Korea remained at below 2, implying that Koreas low IPCR is not a temporary but more structural phenomenon in nature. In this context, the high debt leverage of the corporate sector should be pointed out as the first and major factor behind Korea's low IPCR. Indeed, Figure III-3 shows that Korea dwarfs other Asian countries in the cross-country comparison of debt-equity ratio.

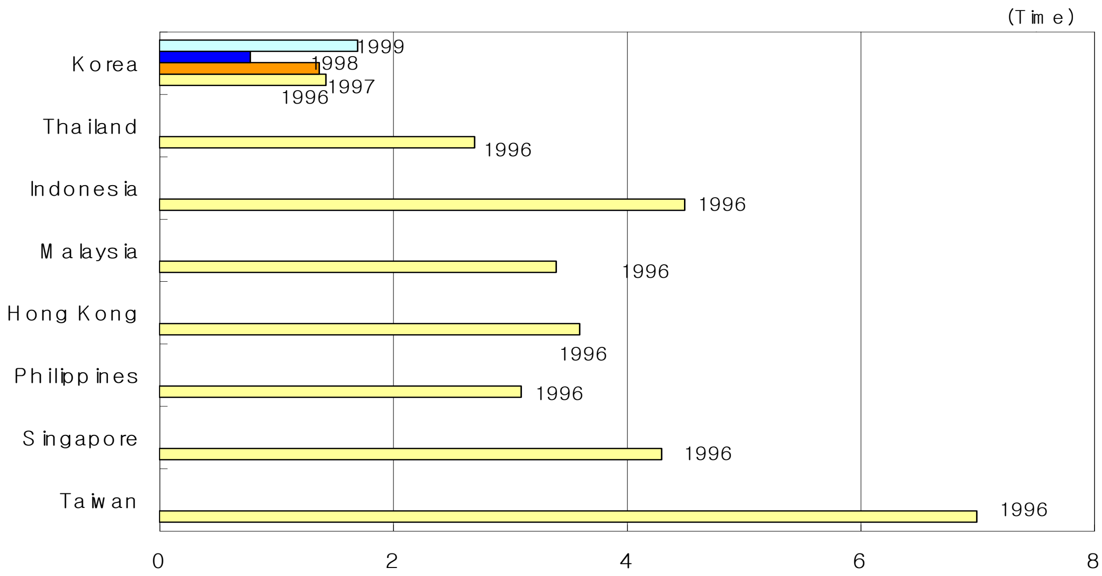
**<Figure III-1> IPCR of Listed Firms in Korea**

(Unit: times)



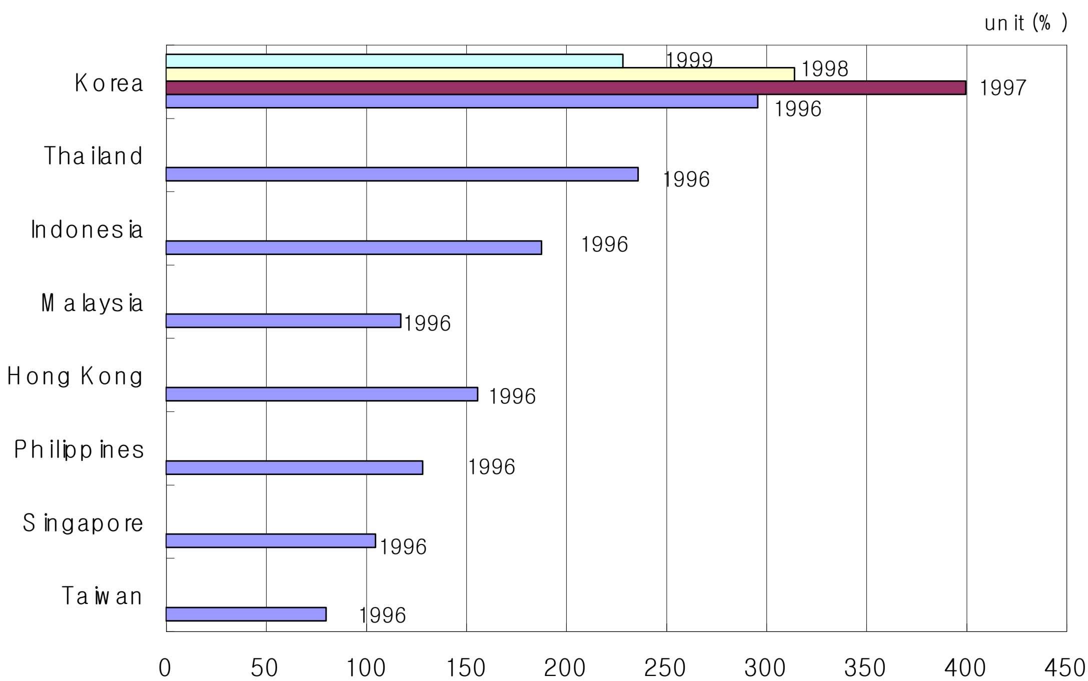

Note: 1) Figures for 1999 are those for the first half of 1999.
Data *Source*: National Information and Credit Evaluation Inc.

**<Figure III-2> International Comparison of IPCR**




Note: 1) Korean figure for 1999 refers to the first half of 1999.
2) All figures for Korea are weighted averages while those for other countries represent median.
Data *Source*: National Information and Credit Evaluation Inc. Claessens, Djankov and Lang (1988).

**<Figure III-3> International Comparison of Debt-Equity Ratio**




Note: 1) Korean figure for 1999 refers to the first half of 1999.
2) All figures for Korea are weighted averages while those for other countries represent median.
Data *Source*: National Information and Credit Evaluation Inc. Claessens, Djankov and Lang (1988).

### (2) Government Intervention in Big Deals

It is suspicious that the Big Deals have produced any significant improvement in the financial soundness and the competitiveness of Korea's corporate sector as a whole. It should first be noted that although the major rationale behind the Big Deals was the elimination of excess capacity, there was little effort to do so by merged firms through Big Deals. Moreover, the Big Deals have been pursued with no consensus on whether excess capacity existed or not, an issue which is controversial even now.

Another adverse impact that would arise from the Big Deals is that they may limit market competition, and hence, further intensify the c*haebols*' monopoly position in the market and unfair business practices. In addition, if the Big Deals indeed increase the combined value of firms to be merged, the firms must have an incentive to voluntarily merge without government intervention. In light of these points, there is no theoretical ground for strong government intervention in the process of Big Deals. Furthermore, the strong intervention, both implicit and explicit, in the Big Deals would make the government run a risk of being liable to possible business failures after mergers.

### (3) Obstacles in Corporate Workout

Workout programs have played a pivotal role in preventing massive corporate bankruptcies over the process of crisis resolution. Given that Korea lacked efficient formal insolvency procedures, workout programs have served as a second vehicle to rehabilitate troubled but viable firms in a more expedited manner. Indeed, many cases of successful rehabilitation through workout programs can be easily found. The Corporate Restructuring Committee, which is a steering committee for corporate restructuring, has already recommended financial creditors to graduate 15 firms from workout programs on the ground of visible improvement in financial soundness and business performance of those firms.

Nonetheless, several obstacles in implementing workout programs have been identified. First, not only troubled firms in question but also their creditors have been exposed to moral hazard problems in that they tend to overstate the viability or future cash flows of firms in question. Obviously, troubled firms have strong incentive to conceal accurate information on their financial status in order to attract more financial support and less harsh restructuring measures. Financial creditors, which have been suffering from large NPLs and capital erosion, also have a distorted incentive to apply lenient accounting standards to their client firms in order to meet the capital adequacy requirement.

Second, the debt-equity swaps have been under-utilized by financial creditors mainly due to the firms' perceived risks of losing managerial control. As of the end of 1999, the actual amount of the debt-equity swaps, including the conversion of debt into convertible bonds, was only 2.2 trillion won, far below the planned target of 5.5 trillion won.

As a result, restructuring plans have often been revised over time to be more consistent with true financial status of firms in question. Indeed, since the end of 1999, 16 firms out of 65 non-Daewoo workout firms in total have revised their restructuring plans. Accordingly, financial creditors rearranged debt rescheduling plans for those 16 firms with increased debt-equity swaps and changes in management. Total debt of those 16 firms amounted to about 18 trillion won, accounting for more than 50% of total debt owed by 65 non-Daewoo workout firms.

Third, an effective coordination among creditors has been difficult to achieve given the absence of legal enforceability in workout programs. In particular, there has been a serious conflict of interest between main banks and other financial creditors with respect to the injection of new money into debtor firms. This conflict was manifested in the case of the resolution of Daewoo. Financial creditors were reluctant to provide new money to Daewoo as they have already been suffering large NPLs and associated burden of loan-loss provisioning.

Fourth, creditor banks have lacked enough incentives to strictly enforce restructuring measures and monitor compliance and performance of debtor firms in the process of workout. In this regard, it should be pointed out that most banks were nationalized in the process of financial sector restructuring. As a result, bank management tends to rely more on the government support than on commercial orientation.

Last but not the least, the inefficient formal insolvency procedure, which is costly to even creditors, often created perverse incentives for a debtor company to hold out in the hopes of extracting a bigger concession from the creditors.

## IV. Corporate Governance Reform and Assessment

### 1. Corporate Governance and the Kim Dae Jung Administration's (1998--) Corporate Restructuring Measures

Corporate governance of South Korea's leading *chaebol* is likely to change with the current round of restructuring efforts. In order to shed light on the basic principles of corporate restructuring, we reviewed different methods of corporate governance.

First, in the market-based approach, which is the governance system found in many advanced industrialized economies including the U.S., the primary objective of management is to maximize the profit of shareholders. Assessment of management is reflected on stock prices, which in turn control managers. The management efficiency can be assessed by the ups and downs of stock prices. If the stock price goes down, hostile M&A, representative competition, and changes in management may follow. On the one hand, this method is considered an objective and optimal method since the market evaluates management performance. On the other hand, it is criticized since it could bring myopic and shortsighted management decisions because stock prices reflect primarily short-term achievement of corporations (Kang 1998). The market-based approach can control only after inefficient management decisions have been made, and therefore, costs of management supervision are quite high.

Second, the structure-based approach has been adopted as a way of corporate governance in Germany and Japan. According to this method, stakeholders such as stockholders, banks, employees, subsidiaries, and so on participate in the executive directors' meeting or unofficial meetings in order to supervise management. The action of stakeholders prevents managers' arbitrary decisions and forces the managers to reconsider the efficiency of their management decisions. In general, institutional investors, who issue corporation stocks and retain corporate bonds, take part in the managing of corporations by assigning outside directors, who represent their position to the board of directors as well as through unofficial meetings (Doremus 1998:33). This method can prevent inefficient management in advance, and so it is more efficient in terms of cost compared to the market-based approach. Although there are advantages in the structure-based method, since the stakeholder' opinion can be fully reflected in the decision-making process and the rights of managers can be secured, there are disadvantages as well. For example, if corporations have large loans from banks, the banks' influence on corporations could increase, which can lead to collusion between the two and inefficient management.

Third, the owner-management domination method has been used in countries with underdeveloped capital or financial markets. According to this method, owner-managers, their family and relatives participate in management. Since owners participate in management, the agent problem, which can happen between majority shareholders and managers, is rare. In addition, speedy decision-making and active management is some of the advantages of the owner-management domination method. However, since majority shareholders, who are owner-managers, are directly involved in management, it decreases the degree of independence of the board of directors and auditors (Kang 1998).

The owner-management domination method has been prevalent in South Korea. However, South Korea is currently undergoing corporate restructuring, and South Korean firms must find a new corporate governance structure.

The Kim Dae Jung administration's corporate restructuring plans will be examined in light of these three different methods of corporate governance. The Kim Dae Jung administration is aware that a "band aid" solution, with only minor changes in the financial and corporate sectors will not bring durable economic growth. Thus, the Kim administration proposed restructuring the *chaebol* based on market principles as follows: (1) enhanced transparency; (2) resolution of cross-debt guarantees; (3) improvement of financial structure; (4) streamlining business activities; and (5) strengthening accountability (Ministry of Finance and Economy 1998:21-28). Enhanced transparency requires adopting new accounting and auditing rules in line with internationally accepted standards as well as the establishment of an external auditors committee. It also involves strengthening the legal protection of the rights of minority shareholders and compulsory appointment of outside directors.

Measures to strengthen accountability of owners/managers are also in the works. First, in order to improve the decision making process in the board of director, the role of company directors has been enhanced. The responsibility of directors was reinforced by introducing fiduciary duty of directors. *De facto directors* including controlling shareholders are now subject to the same legal obligations as elected directors. In addition, listed companies are required to appoint outside directors, whose number should be no less than one-fourth of the total number in the board of directors beginning in 1999. For large size listed corporations with total assets of over 2 trillion won, this requirement is scheduled to be raised to one-half of the board by 2001. By the end of 1999, all 725 listed companies appointed 1,236 outside directors.

Second, in order to protect minority shareholders' rights various measures are to go into effect. Thresholds for various initiatives will be lowered in the following cases including removal of a director, and right to file a derivative suit, and to inspect account books. These measures are designed to protect minority shareholders from expropriation by dominant shareholders and mangers.

**Table IV-1**

**Key Item of Minority Shareholders' Rights**

| | Former Commercial Code | Amendments | Securities and Exchange Act |
|---|---|---|---|
| Removal of a Director | 5% | 3% (Art.385②) | 0.5%(0.25%) (Art.191/13②) |
| Right to Injunction | 5% | 1% (Art.402) | 0.5%(0.25%) (Art.191/13②) |
| Derivative Suit | 5% | 1% (Art.403) | 0.01% (Art.191/13①) |
| Shareholder's Proposal | - | 3% (Art.363②) | 1%(0.5%) (Art.191/14①) |
| Demand for Convocation | 5% | 3% (Art.366①) | 3%(1.5%) (Art.191/13④) |
| Right to Inspect Account Books | 5% | 3% (Art.466①) | 1%(0.5%) (Art.191/13③) |
| Right to Inspect Affairs and Company Property | 5% | 3% (Art.467①) | 3%(1.5%) (Art.191/13④) |
| Removal of Liquidation | 5% | 3% (Art.539②) | 0.5%(0.25%) (Art.191/13②) |

* Appraisal rights of SGM's convocation and shareholder proposals estimated on the base of voting stocks.

** Parentheses show the case of corporations with more than 100 billion won, paid-in capital in the end of the recent business year.

In addition, a cumulative voting system has been introduced beginning in June 1999 in order to enable minority shareholders to elect a director, who best represents their interests. Under this new system, shareholders with less than 3% of outstanding stocks will be able to make a claim for cumulative voting. However, this is not mandatory. Most listed *chaebol* member firms, including each of the core companies of the five groups, have amended their charter to prevent cumulative voting. Thus, about 30% of all listed corporations have adopted this system. Minority shareholders' rights are summarized in Table IV-1.

It appears that the Kim administration is pursuing corporate governance in line with the market principles. However, in order for this corporate governance reform to be successful, it is imperative that there has to be significant improvements in the soundness of the stock market as well as financial institutions.

## 2. Survey of the South Korean *Chaebol*

A survey of South Korean businesses[1] was conducted with generous funding from the International Centre for the Study of East Asia Development (ICSEAD). Preparations for the survey and the survey took place from March to September 1999.

This survey examined to what extents the *chaebol* have undergone real and effective changes in corporate governance and have improved their global competitiveness. Although the *chaebol* down-sized their member firms through active mergers and acquisitions, business-swaps (*Big Deals*), and so on, business will be "business as usual" if their corporate governance does not change. Thus, this survey focuses on whether there are changes in the *chaebol*'s family ownership and management practices, and in various inter- and intra-*chaebol* relationships. Also, it investigates whether the recent

[1] This paper deals exclusively with the five largest business group (*chaebol*) in South Korea.

restructuring efforts led to improved global competitiveness, or led to mere short-term window-dressing to conform to the IMF's and the South Korean government's corporate restructuring mandates.

The following researchers conducted this survey:

* Principal Researcher: Dr. Eun Mee Kim

* Consultant: Dr. Dukjin Chang, Professor, Social Studies Department, Ewha

Womans University

* Interviewers: Yoo-Jung Ha, A-ri Kim, Jeom Kim, Jin-ah Kim, and Hyo-Jung

Park; graduate students, the Graduate School of International Studies, Ewha

Womans University

* Data Analysis: Jin-ah Kim, Soyoung Kim, Kishil Yang, graduate students,

The Graduate School of International Studies, Ewha Womans University

Face-to-face, structured interview was selected as the mode of data collection rather than mailed questionnaire in order to increase the response rate and accuracy of responses. Interviewers were trained in Seoul and interviews were conducted in the business sites throughout South Korea in the months of August and September 1999. We gratefully acknowledge the cooperation of firms, which responded favorably to our interviews. Without their support, this study would not have been completed.

### (1) Research Design

### A. Objectives of the Survey

The survey is a part of a larger effort to examine the changes in South Korea's *chaebol* in terms of family-ownership, family-management, hierarchical relationship among member firms, and the relationship among the *chaebol* since the financial crisis of 1997. The objectives of the survey can be classified broadly into three areas:

1) Changes in family-ownership and -management since the financial crisis and restructuring;

2) Changes in the intra-*chaebol* member firms' relationships, and inter-*chaebol* relationships since the financial crisis and restructuring; and

3) Changes in global competitiveness as a result of changes in the family-ownership and -management, and intra- and inter-*chaebol* relationships.

First, the survey is intended to study how one of the most important characteristics of the South Korean *chaebol* --i.e., family-ownership and -

management-- changed after the financial crisis and restructuring. Similar to the Japanese *zaibatsu* prior to the World War II, the *chaebol* has often been owned and managed by one or two families. A powerful chair coordinates the large number of *chaebol*'s member firms. The chair derives his power through ownership, as well as tight control over his sons and brothers, who dominate the boards of directors (Kim 1997: 58). Family ties among top executives are strong, and filial piety among them is the basis of *chaebol* management. The *chaebol* retain family-ownership and -management even after the succession of ownership from the first to the next generation of owners.

However, the expansion of the *chaebol*, and the growing number of member companies, made it inevitable to train and recruit professional managers, who are not members of the founder's family. Shin and Chin's (1989) study shows that the board of directors is connected by ties of family, region of birth, and high school affiliation. Of these ties, those of family were the most important. There was a definite hierarchical order: the first tier of managers was dominated by family members, while the second tier was recruited by the first tier from among high school and college alumnae and those from the same hometown (Kim 1997: 64). By recruiting from pools of "familiar" people, the *chaebol* is able to retain a strong sense of "closeness" compared to recruiting people without such ties. Thus, recruitment based on personal ties has been practiced widely in order to sustain a familistic character (Kim 1997: 62).

The second objective of the survey is to examine the changes in inter- and intra-*chaebol* relationship after the financial crisis and restructuring in terms of sales, purchase, exports, research and development (R & D), technology transfers, and management decisions including personnel and budget. The most prominent feature in the intra-*chaebol* relationship is the fact that the chair of the *chaebol* and the member companies act like that of father and sons in a Confucian society, in which the father has complete authority over his sons (Kim 1997: 65). The flexibility and speed in the *chaebol*'s decision-making comes from the fact that the father makes and executes decisions without consulting others. The *chaebol*'s flexibility also comes from its ability to mobilize and transfer personnel between member companies. For example, it is common for high-ranking personnel to be transferred, often to head a member company that has a high–growth profile or else is ailing. In addition, the successor to the chair is often trained in many companies within the group in order to broaden his knowledge of operations and to allow him to interact with managers of as many member companies as possible.

Member companies of a *chaebol* frequently pool their resources for key services. Research and development are often coordinated among member companies, and expenses and even laboratory space may be shared. Although the ownership of companies is maintained separately, the transfer of immediate cash funds can be arranged through financial-service and insurance companies, and companies can provide each other with loans without going through complicated bureaucratic procedures (Kim 1997:66).

The last goal of the survey is to examine whether the changes in family-ownership and -management and in the inter- and intra-*chaebol* relationship due to the restructuring improved the firm's performance and enhanced its global competitiveness. The ultimate goal of corporate restructuring is to improve the global competitiveness of South Korean firms. However, the current restructuring efforts in the *chaebol* have focused more on buying and selling of firms in order to reduce debt/equity ratios and streamline its main businesses. It is not clear whether such efforts bore fruit in terms of global competitiveness.

Thus, Part III of the survey asks questions more directly about the restructuring process –i.e., how the employees "see" the restructuring process and their assessment of the restructuring efforts at their firm. Enhancement in global competitiveness will be examined by using the current account balance. This measure will help us determine whether changes in corporate governance have brought significant improvements in the *chaebol*'s competitiveness.

The following hypotheses were generated based on the above three goals:

**H1**: The family-ownership and -management as one of the major features of the South Korean *chaebol* has weakened since the restructuring.

**H2**: The intra-*chaebol* relationship has become less hierarchical, and there is increased independence of member firms since the restructuring. Also, the inter-*chaebol* relationship has become less exclusive.

**H3**: In spite of the changes in the family-ownership and -management, and the intra- and inter-*chaebol* relationship, global competitiveness of the South Korean *chaebol* has not improved significantly. This is possibly due to the fact that restructuring was coerced by external forces, such as the government, rather than conducted by the companies' own internal needs.

## B. Survey Method

The research utilized structured, face-to-face interviews with the *chaebol*'s senior management officials of the largest five *chaebol*. Due to the possibility of a high refusal rate for interviews, all firms belonging to the largest five *chaebol* as of August 1999 (total 204 firms) were contacted. The list of senior officials was selected once the firms were chosen.

The *Current Conglomerates' Member Firms List* released in August 1999 by the Korea Fair Trade Commission (KFTC) was used as a sampling frame to list the population of 204 corporations, which are member firms of the five largest *chaebol* (see Appendix B).[2] We identified the five largest *chaebol* using the same source.

**Table IV-2**

**The List of the Member Firms of the Five Largest *Chaebol***

| Rank | *Chaebol* | Total assets* (Billion Won) | Total number of firms** | Number of interviewed firms | Response Rate |
|---|---|---|---|---|---|
| 1 | Hyundai | 88,806 | 53 | 11 | 20.8% |
| 2 | Daewoo | 78,168 | 27 | 3 | 11.1% |
| 3 | Samsung | 61,606 | 47 | 8 | 17.0% |
| 4 | LG | 49,524 | 41 | 9 | 22.0% |
| 5 | SK | 32,766 | 36 | 8 | 22.2% |
| Total | | 310,870 | 204 | 39 | 19.1% |

Sources: KFTC, *The Current Conglomerates' Member Firms List* August 1999; *1999 Annual Rank of Korean Conglomerate,* April 1999.
Notes: * Rank order of South Korean conglomerates based on total assets (KFTC April 1, 1999).
** The number of firms was based on August 1, 1999.

Table IV-2 shows the number of member firms of the five largest *chaebol* listed in the sampling frame. The rank order of business groups is based on their total assets as of August 1, 1999. The response rate was 19.1%.

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[2] The list of the *chaebol*'s member firms changed almost daily during the survey due to turbulent economic fluctuations. Thus, we decided to use the data from the KFTC, which is one of the most reliable organizations working on the *chaebol*.

Thirty-nine out of a total of 204 firms participated in the survey. The response rate ranged from a low of 11.1% in Daewoo to a high of 22.2% in SK.

Face-to-face structured interview was used not only to obtain a higher response rate, but most importantly, to increase the accuracy and reliability of the survey. Five interviewers were selected from the Graduate School of International Studies of the Ewha Womans University. Interviewer training took place in July 1999, and interviewers were dispatched throughout South Korea to conduct interviews in August and September 1999. After making interview appointments by phone, interviews took place in corporations with the general manager of the corporate planning division or it’s equivalent. Each interview took approximately thirty minutes to complete. The questionnaire is included in Appendix A.

As we anticipated, the interviewee selection was very difficult. Many member firms of the largest five *chaebol* were themselves in the process of *Big Deals* or restructuring including business swaps, mergers and acquisitions (M & A), and streamlining of businesses. They were hardly interested in participating in a survey about restructuring, since restructuring was affecting their very jobs. Furthermore, general managers or directors, who were the targeted interviewees, were difficult to contact, since many were extremely busy as they were involved in making daily decisions about layoffs and broader restructuring issues.

The number of member companies of *chaebol* changed almost daily. For example, the number of member companies of the largest five largest *chaebol* was 216 in July 1999, 204 in August 1999, 189 in October 1999, 166 in

February 2000, and 172 on March 2, 2000.[3] Nevertheless, the dynamic nature of restructuring was captured in the survey as a representative of the restructuring process.

### C. Survey Questions

The survey questionnaire consists of three parts with twenty-two questions. Part I (questions 1 to 7) deals with the changes in family-ownership and -management since the financial crisis. Part II (questions 8 to 14) focuses on changes in the inter- and intra-*chaebol* relationships since the financial crisis. And Part III (questions 15 to 22) deals with the process of corporate restructuring itself.

In part I, question 1 deals with the number of outside directors and their social position in order to examine the changes in family management. Questions 2 to 6 examine the *chaebol*'s founder's and her/his family's involvement in various management decisions including the selection of the board of directors. Question 7 is to find the reason for <u>not hiring</u> the *chaebol's* founder's family members. Although questions usually ask reasons for doing something, we decided to ask this question in a negative way. This is because it is commonly known that South Korean corporations often have the founder's family members as the chief executive officers (CEOs) or as members on the

[3] These figures are from the *Current Conglomerates' Member Firms List* released by KFTC on July 1, 1999, August 1, 1999, October 1, 1999, February 1, 2000, and March 1, 2000, respectively. The number of member companies of the five largest *chaebol* has decreased steadily since the financial crisis until February 2000, but it began to rise again in March 2000. An official from the KFTC explained that this is because the corporate restructuring efforts of the Kim Dae Jung administration focused on the largest five *chaebol* in 1999, and thus the reduction of the *chaebol* member firms slowed in 2000. The official suspected that the largest *chaebol* were in the process of some expansion after severe belt-tightening since the financial crisis erupted in 1997.

board of directors.   Thus, the question asks why the interviewee firm does not follow a common practice.

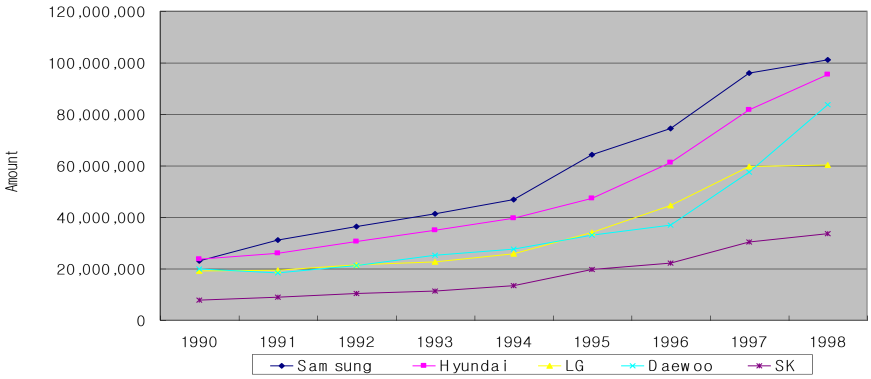
Questions 8 to 18 in part II focus on the changes in inter- and intra-*chaebol* relationships since the financial crisis in terms of sales, purchase, exports, R & D, technology transfers, and management decisions on personnel and budget.

Finally, questions 19 to 22 examine whether the restructuring process has been adequately implemented to improve the firm's performance and enhance its global competitiveness.

### (2) Major Trends of the Five Largest *Chaebol* in the 1990s

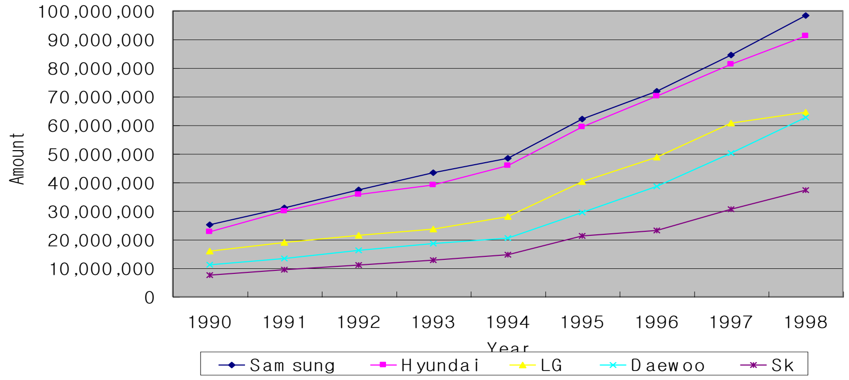
A brief examination of key economic indicators of the largest five *chaebol* in the 1990s is provided below.   First, total assets in Figure IV-1 show that the five *chaebol*'s growth accelerated since the mid-1990s.   The financial crisis apparently did not affect their total assets as of 1998, with only moderate tempering effects shown in LG and SK.   Daewoo, on the other hand, showed a sharp increase in total assets in 1998, which was probably due to the rise in total debt.

Figure IV-1
Total Assets of the Five Chaebol
(Unit: One Million Korean Won)



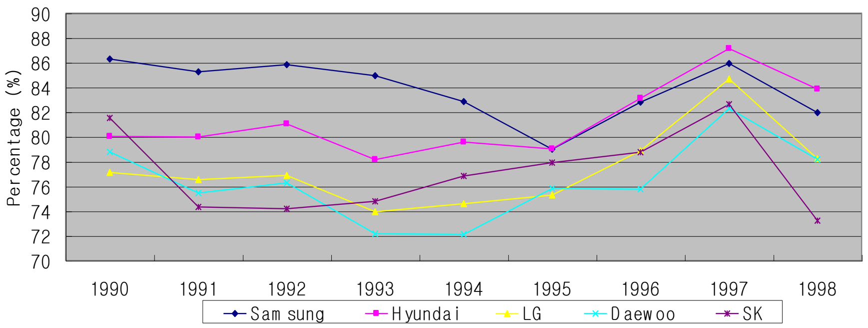
Total sales also show that the largest five *chaebol* were not severely hurt by the financial crisis (see Figure IV-2). In fact, four *chaebol* showed a sharper increase in total sales between 1997 and 1998 compared to the previous year.

Figure IV-2
Total Sales of the Five Chaebol
(Unit: One Million Korean Won)




Debt/equity ratios, on the other hand, showed a greater fluctuation throughout the 1990s (see Figure IV-3). The figures show that the *chaebol*'s debt/equity ratios recorded the highest level in 1997, followed by a sharp decline in 1998 and 1999. One noteworthy fact is that Daewoo, which is in the process of disbandment, is the only *chaebol* showing an increase of debt/equity in 1998 and 1999 predicting its misfortune.

Figure IV-3
Percentage of Debt in Total Asset



These figures show that the financial crisis has not unduly affected the largest five *chaebol*. They seem to continue their rapid growth, at least up to 1998. One interesting fact is Daewoo's relatively moderate decline in the debt/equity ratio in 1998, while the other four largest *chaebol* show a quicker response to the South Korean government's and the IMF's mandate to reduce the debt/equity ratio. In sum, the largest five *chaebol* do not show a dramatic downturn on their business activities in 1998 immediately after the financial crisis. It will be very important to monitor the changes in these statistics for 1999, when the data becomes available.

## 3. Family-Ownership and Family-Management

In order to examine the changes before and after the financial crisis, we compared the current survey's findings to those of a 1992 survey conducted by the principal investigator (Kim and Cho 1993). The 1992 survey included similar questions on family-ownership and –management, and intra- and inter-*chaebol* relationships.

One of the most important characteristics of the *chaebol* has been the fact that management is not separated from the founder's family. Although many of South Korea's largest *chaebol* have been in existence for over a half-century, they have not shed family-ownership, which in most cases disappear with the expansion and diversification of a firm. Although not explicitly stated as a corporate restructuring goal, the South Korean government has sent an unmistakable warning to the *chaebol* that mis-management and opaque management practices, which are possible under the founder-manager system, should be eradicated. "Transparency in management" and "accountability in management" is a strong message from the South Korean government that it will no longer tolerate the near-dictatorial authority the *chaebol* chair has in management.

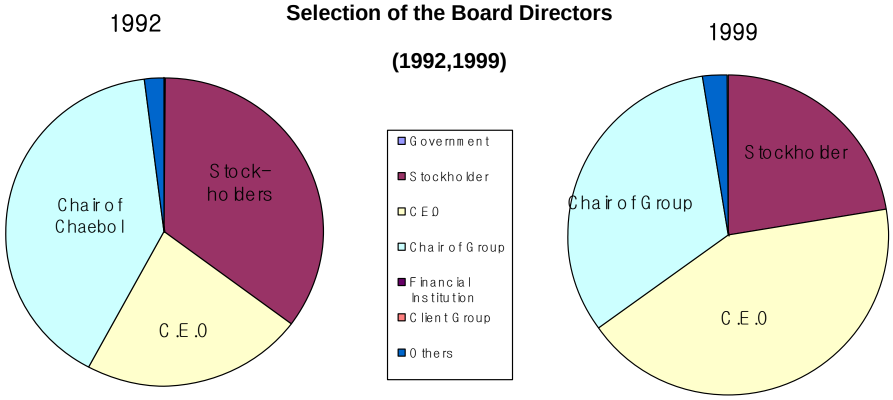
One of the measures mandated by the South Korean government is to hire an outside director to better oversee management. Question 1 deals with this issue, and the findings show that although many firms have brought in an outside director, still over half (54.1%) of the respondent firms have not recruited an outside director.

Question 2 was asked in order to examine whether the chair of the *chaebol* continues to wield power in the selection of the board of directors. Comparison of the survey findings between 1992 and 1999 show that although the chair's influence has decreased from 40.3% in 1992 to 32.5% in 1999, s/he still plays an influential role (see Figure IV-4). Nonetheless, it is encouraging to note that in 1999 the CEO has a larger voice in the selection of the board of directors compared to the chair, who had the largest voice in 1992.

**Figure IV-4**

**Selection of the Board Directors**

**(1992,1999)**

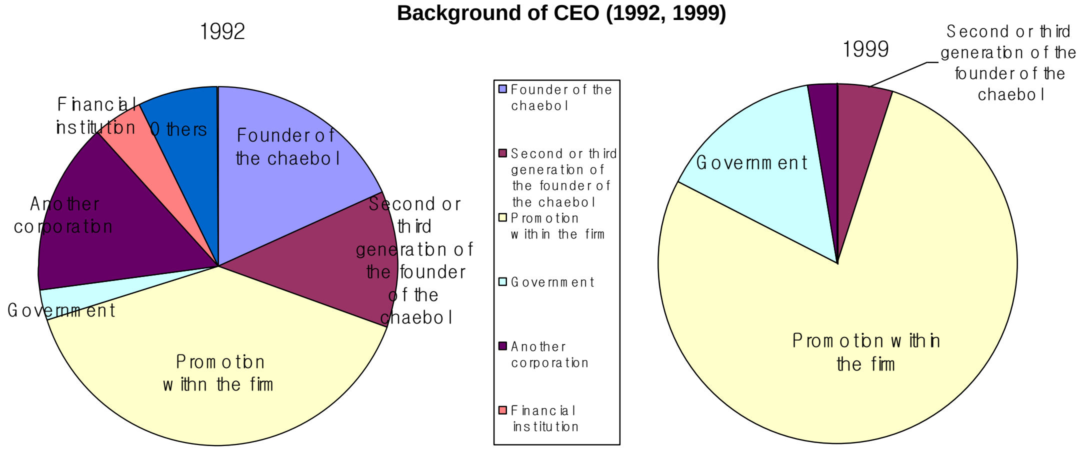



In an effort to examine whether the CEOs are still associated with the founder's family, which could undermine the results from Question 2, we asked about the background of the CEO. Results from Question 3 are very promising (see Figure IV-5). The findings show that in 1992, about 30% of the CEOs were either the founder him/herself or the second or third generation of the founder. However, in 1999, only 5% of respondents reported that their firm's CEOs were directly related to the founder, while an overwhelming share of CEOs were recruited from within the firm (77.5%). This implies that there have been significant improvements in terms of recruitment and promotion of "professional managers" even in the short period between 1992 and 1999.

This pattern of hiring and retaining professional managers reflects two important changes in South Korean businesses: (1) the tremendous expansion and increased complexity of businesses made it inevitable to utilize highly-trained professional managers in order to lead their businesses into the twenty-first century; and (2) the unchecked influence of the founder's family is decreasing. However, the latter issue needs to be understood with a grain of salt. We need to examine further whether the increase of professional managers has really led to any measurable decrease in the influence of the founder's family. This is because it has been noted that the founder's family can "effectively" manage the *chaebol* with even less than 10% ownership.

**Figure IV-5**

**Background of CEO (1992, 1999)**



### 4. Inter-*Chaebol* and Intra-*Chaebol* Relationships

An interesting phenomenon observed during the interviews was the fact that the respondents were very uncomfortable about answering questions from this section. Answers to Questions 10, 12-14 were filled with "don't know" responses. Therefore, it is difficult to discuss these findings. We suspect that the respondents were fully aware of the South Korean government's and the IMF's warning against "unlawful" and "illicit" transactions within the *chaebol*, and avoided answering these questions with the fear that they might appear to be engaging in such illegal business transactions. Another interpretation could be that the questions were not user-friendly –e.g., the questions ask detailed input-output figures for internal sales, purchases, R & D, etc.--, and thus it was difficult for the respondents to answer.

Nonetheless, we were still able to review some interesting findings from the responses in this section. In a question about the role of the mother firm in the 1992 survey, 73.9% of the respondents said that the mother firm invested capital in the respondent's firm. Fewer responses were recorded for being involved in management (37.7%), providing technology (18.8%), and being involved in personnel decisions (24.6%). A similar question was asked in the 1999 survey (Question 9). Instead of asking about the mother firm, this question asked about the relationship to a firm, which plays the most influential role in the respondent's firm. The results were quite similar; over half of the respondents (51.6%) said that the most influential firm provided capital. Other modes of involvement were less pronounced in 1999. Thus, the findings imply that although the member firms of a *chaebol* may be related, the extent of the relationship does not go beyond providing capital. It will be important to further examine this issue to see whether this represents a significant departure from past practices, or it merely reflects the current restructuring efforts.

Responses to Question 11 reveal that although the *chaebol* member firms see the benefit of membership in a *chaebol* in very practical terms (28.9% for "stable supply of parts and material," and 31.6% for "stable sales of products"), they also see that it gives them "social prestige" (28.9%). We find this an interesting irony. In 1999 when the survey was conducted, the *chaebol* were under serious attack from the public as well as the government for being at least partly responsible for the financial crisis. Yet, the members of the *chaebol* still see that they carry certain social prestige and that their jobs are desirable even in an age of great economic turmoil.

## 5. Corporate Restructuring and Global Competitiveness

Part III of the survey dealt with the restructuring process itself. Questions in this section were designed to see how the *chaebol* themselves understood the restructuring process occurring in their firms. In response to the question about the main goal of the firm's restructuring efforts, 44.1% responded that it was to improve the financial situation and 41.2% responded that it was to upgrade their business activities. Transparency in decision-making, streamlining business activities, or downsizing were not considered to be major goals of restructuring. This shows that the *chaebol* are quite responsive to "financial constraints" in the restructuring process, and implies that this could be used as an effective tool to push for further corporate restructuring.

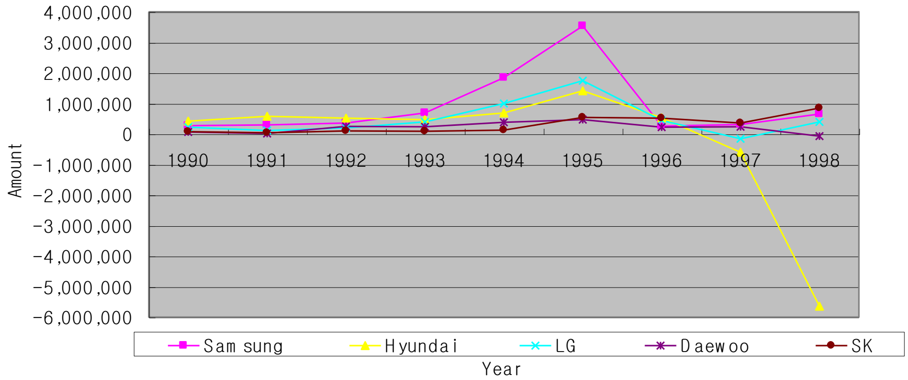
In a related question, we asked what was the most likely outcome of the firm's restructuring efforts (Question 17). The responses revealed that the *chaebol* were quite optimistic about improving their financial situation (41.2%)

and upgrading business activities (29.4%), and thought that they will also experience some down-sizing although it was not a professed goal of the firm's restructuring.

It is quite interesting to note that the respondents felt very strongly that labor unions were the biggest obstacle against restructuring (36.4%), followed by the government (15.2%). These findings clearly show that the *chaebol* member firms see outside influences –i.e., labor and the government— as the main obstacle against corporate restructuring. They are still unable or unwilling to see that perhaps the management and family-ownership and – management may be the greatest obstacle. In most cases, the *chaebol* member firms believed that restructuring is a necessary process and that it is being adequately implemented at his/her firm.

It is very difficult to define and operationalize the concept of global competitiveness. As one proxy, we used the net profit in sales, which is an important indicator of a firm's management performance. It measures how a firm effectively controlled (or, minimized) its input costs and at the same time maximized its net profit through sales. The figures for the largest five *chaebol* are presented in Figure IV-6. The figures show that the five *chaebol* recorded the highest net profit in sales in 1995. What is noteworthy is that the net profit in sales actually showed a sharp decline in 1996, one year before the financial crisis. The net profit improved only very modestly for Samsung and LG in 1998. And to our surprise, Hyundai's net profit in sales showed a dramatic decline in 1998. We need to examine other sources to verify these findings. It would also be important to compare the *chaebol*'s performance to that of comparable transnational corporations (TNCs) from other newly industrializing countries (NICs).

Figure IV-6
Current Account Balance
(Unit: One Million Korean Won)




The current restructuring efforts of the largest *chaebol* are nothing new in South Korea. Each time a new president came to power in South Korea's modern history, announcements were made, and in some cases, real action took place, to urge/order the *chaebol* to "reform," "restructure," or "rationalize." Some have failed while others have brought changes to not only the map of the largest *chaebol*, but also in the internal structure of the *chaebol*. However, the current wave of corporate restructuring is different in a significant way: the IMF. The IMF exerts real pressure for corporate restructuring not only to the *chaebol*, who are the primary target of reform, but also to the South Korean government. The latter is under great pressure from the IMF to make sure that the former follows the IMF mandate for corporate restructuring. Thus, many predict that it will be difficult for the government or the *chaebol* to not comply with the current restructuring plans.

We conducted a survey of the member firms of the largest five *chaebol* to understand the extent to which corporate restructuring has actually brought about changes in management. The findings are mixed. The founder and his/her family appear to play a lesser role in management, at least in a formal sense. On the other hand, the chairs of the major *chaebol* have not stepped down, but instead have in some cases assumed the role of CEO to become more visibly and legally involved in management. News about Daewoo's chair, Kim Woo Choong, resigning from the chair is in fact newsworthy since it is still a rarity among South Korea's leading *chaebol*. The tremendous influence of the honorary chair and founder of the Hyundai *chaebol*, the 85 year old Chung Ju Young, in the March 2000 succession crisis of the Hyundai group is another clear example that the chair and/or founder of a *chaebol* is tantamount to god in these *chaebol*[4]. It is astonishing that this succession crisis occurred in the midst of corporate restructuring. It is unthinkable in businesses in other countries to have the founder, who is not even an active member of the business group (at least on the books) and has the title of honorary chair, can single-handedly decide the next chair of the business group. Secondly, the process of deciding the future direction of a major conglomerate, which has many listed firms, behind closed doors among the founder and his two sons, is something that is not tolerated in companies with working board of directors and shareholders' meetings. This event shows that genuine change in corporate governance in Korea is far from reality.

The present survey did not produce any significant findings regarding intra- and inter-*chaebol* relationships due to the reluctance of the respondents to answer detailed questions in this section. Nevertheless, we were able to assess that belonging to a *chaebol* appears to provide very tangible benefits such as a stable source of inputs and sales, as well as social prestige. The fact that the employees of the *chaebol* still felt social prestige as a member of a *chaebol* even when there exists tremendous ill feelings against the *chaebol* imply that it will

[4] Hyundai *chaebol* had two chairs after the founder, Chung Ju Young, stepped down from the chair. The two chairs of Hyundai, Chung Mong Ku and Chung Mong Hun, are the sons of the founder Mr. Chung. The succession fiasco began on March 14, 2000 and lasted for 13 days, during which period the power game between the two younger Chungs escalated. After a series of reversals and secret meetings, the senior Mr. Chung announced on March 27, 2000 that the fifth son, Mong Hun, would be the sole chair of

be difficult to completely eradicate or disband the *chaebol* in the near future. This is a business system, which many consider to be unique to South Korea and important for the visibility and vitality of the South Korean firms in the global market.

Findings in the last section of the survey revealed that many in the *chaebol* actually saw corporate restructuring as a necessary process. The respondents also felt strongly that improving their firm's financial structure is the most important goal and expected outcome of the restructuring process. For global competitiveness, we saw that the largest *chaebol* actually began to show warning signs as early as 196. Hyundai, to our surprise, showed the worst net profit in sales among the five largest *chaebol*. As we anticipated, we did not observe any measurable improvements in the net profit in sales, except for a modest increase in Samsung. It is perhaps to soon to measure any conspicuous improvement in global competitiveness, since the restructuring process just began. It will be important to monitor such indicators of global competitiveness in the next few years to see whether the current restructuring efforts will bear fruit. It will also be important to follow the changes in Hyundai, which showed a very dangerous level of sharp decline of net profit in sales in 1998.

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the Hyundai *chaebol* and that the second son, Mong Ku, would focus on Hyundai Motors and Kia Motors.

# V. Financial Sector Restructuring: Progress and Assessment

## 1. Restructuring Measures and Progress

At the time of the crisis, many Korean banks were significantly under capitalized and several of them were effectively wiped out of their capital base. Because of large NPLs and weak capital base, troubled Korean financial institutions struggled to improve their BIS ratios by curtailing lending as raising new capital was virtually impossible. Such financial implosion further intensified the already severe credit crunch and resulted in massive corporate bankruptcies.

Under these circumstances, the top priority in financial restructuring was the disposal of NPLs and the recapitalization of banks. The first policy response by the Korean government was to identify insolvent financial institutions and resolve them by either P&As (purchase and assumptions) or liquidation. As of the end of February 2000, 390 financial institutions in total had their operations suspended or were closed (see Table V-1). In tandem with these measures, the government injected 64 trillion won (14 percent of GDP) in fiscal resources to rehabilitate the financial system between the late 1997 and the end of 1999 (see Table V-2). The operating arms of the government in this regard were the Korea Asset Management Corporation (KAMCO) and the Korea Deposit Insurance Corporation (KDIC).

Since its inception, KAMCO has purchased 55.1 trillion won (book values) in non-performing assets from financial institutions at 20.5 trillion won by the end of February 2000. By February 2000, KAMCO recovered 13.2 trillion won, which accounts for 64% of the injected fiscal money, from the sale of the acquired NPLs of 23.5 trillion won in book value. KAMCO recycled 8.7 trillion won out of the proceeds from the sale of assets into the additional purchase of NPLs from financial institutions. Despite such progress in the disposal of NPLs, Korea's financial sector is still ridden with enormous NPLs of about 58 trillion won, or 10.1% of total loans, as of September 1999, as shown in Table V-3. In particular, NBFIs such as mutual savings and finance companies (MSFCs) and leasing companies are exhibiting extremely high NPL ratios of more than 30%.

The KDIC provided 43.5 trillion won for recapitalization and loss coverage for merging or acquiring institutions (18.6 trillion won), and deposit repayments for closed institutions (24.9 trillion won). As a result, most Korean banks obtained BIS capital adequacy ratios of 10 ~13 percent by the end of 1999. Such improvement in the bank capital structure, coupled with the stabilization of domestic interest rates, contributed significantly to the alleviation of the credit crunch. Indeed, the monthly figures for corporate bankruptcies fell from more than 3,000 in the first quarter of 1998 to about 500 in the fourth quarter of 1999 (see Table II-3).

Financial sector restructuring has also progressed in terms of employment adjustment. By the end of 1999, the total employment of commercial banks declined by 26.7% to reach slightly over 95,000 persons significantly down from more than 130,000 persons at the end of 1997. Moreover, the number of branches has declined by 21.6% to 4,880, down from 6,226 at the end of 1997.

**<Table V-1> Financial Institutions Closed or Suspended**

(As of February, 2000, unit: number of institution)

| | Total No. of Institutions (end-1997) | License Revoked & Suspended | Merger | Others[1)] | Subtotal |
|---|---|---|---|---|---|
| Banks | 33 | 5 | 5 | - | 10 |
| Merchant Bank Companies | 30 | 17 | 3 | 1 | 21 |
| Securities Companies | 36 | 5 | - | 1 | 6 |
| Insurance Companies | 50 | 5 | 2 | - | 7 |
| Investment Trust Companies | 31 | 6 | 1 | - | 7 |
| Mutual Savings and Finance Companies | 231 | 40 | 16 | 10 | 66 |
| Credit Unions | 1,666 | 2 | 61 | 198 | 261 |
| Leasing Companies | 25 | - | 1 | 11 | 12 |
| Total | 2,102 | 80 | 89 | 221 | 390 |

Note: 1) Includes dissolution and asset transfers to bridge institutions.
*Source*: Financial Supervisory Committee.

## <Table V-2> Fiscal Support for Financial Restructuring (11/1997 ~ 2/2000)

(Unit: trillion won)

| | Purchase of NPLs by KAMCO | Recapitalization of Banks and Loss Coverage | Deposit Repayment | Total |
|---|---|---|---|---|
| Commercial Banks | 14.8 (41.2) | 14.6 | 13.3 | 42.7 |
| Specialized Banks | 2.5 (5.8) | - | - | 2.5 |
| NBFIs | 3.2 (8.1) | 4.0 | 11.6 | 18.8 |
| Total | 20.5 (55.1 ) | 18.6 | 24.9 | 64.0 |

Note: Figures in parentheses reflect the book values of NPLs.
*Source:* Financial Supervisory Commission

## <Table V-3> Non-performing Loans

(Unit: trillion won, %)

| | December 1997 | | | December 1998 | | | September 1999 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total Loans A | NPLs B | Ratio B/A | Total Loans A | NPLs B | Ratio B/A | Total Loans A | NPLs B | Ratio B/A |
| Banks | 518.6 | 31.6 | 6.1 | 443.4 | 33.6 | 7.6 | 455.9 | 30.1 | 6.6 |
| Commercial banks | 375.8 | 22.7 | 6.0 | 300.6 | 22.2 | 7.4 | 309.4 | 19.0 | 6.1 |
| Specialized and Development Banks | 142.8 | 8.9 | 6.2 | 142.8 | 11.4 | 8.0 | 146.5 | 11.1 | 7.6 |
| Merchant Banks | 24.1 | 1.0 | 4.1 | 28.0 | 5.6 | 20.0 | 15.2 | 2.2 | 14.5 |
| Insurance Companies | 51.7 | 4.8 | 9.3 | 38.7 | 3.4 | 8.8 | 42.4 | 5.9 | 13.9 |
| Mutual Savings and Finance Companies | 28.1 | 3.3 | 11.7 | 22.0 | 5.3 | 24.1 | 18.5 | 6.8 | 36.8 |
| Credit Unions | 12.7 | 1.3 | 10.2 | 11.2 | 2.5 | 22.3 | 10.2 | 2.8 | 27.5 |
| Leasing Companies | n.a. | n.a. | n.a. | 25.9 | 7.8 | 30.1 | 23.0 | 7.2 | 31.3 |
| Securities Companies | 12.1 | 1.6 | 13.2 | 7.3 | 2.0 | 27.4 | 8.9 | 2.9 | 32.6 |
| Total | 647.3 | 43.6 | 6.7 | 576.5 | 60.2 | 10.4 | 574.1 | 57.9 | 10.1 |

Note: 1) NPLs had been reduced by the 44 trillion won in purchases by KAMCO by March 1999.
*Source:* Financial Supervisory Commission

## 2. Financial Sector Governance and Regulatory Reform

Since the onset of the financial crisis, various measures have been undertaken to strengthen prudential regulations and improve the financial sector's internal and external governance structure. Although not complete, it is quite an impressive advance compared to the pre-crisis situation.

As to the governance reform for the financial sector, the most dramatic and effective measure is no doubt the closure of insolvent institutions. Indeed, the closure of non-viable banks opened a new chapter in Korea's financial history, where no single commercial bank had been closed for the four decades prior to the crisis. But, Korea's financial sector reform has gone one step further by improving regulatory standards and enforcement.

Since January 1998, under the Act Concerning the Structural Improvement of the Financial Industry, the supervisory authority has been able to order the equity write-offs against shareholders deemed responsible for the insolvency of banks. In February 1998, in order to encourage shareholders and internal auditors to assume roles of monitoring management, the requirement conditions for exercising minority shareholders' rights were significantly eased. For instance, the minimum share requirements to exercise rights of minority shareholders, including derivative suits, reduced to one half of those for listed non-financial companies. Also, financial institutions have been required to fill the 50% of their board of directors with outside directors since 1999.

The FSC has also established and executed an efficient sanction system in which, if necessary, civil and criminal liabilities can be imposed on the directors. An equivalent sanction can be imposed on the external auditor and examiners of supervisory authorities for neglect of duties. One prime example is the derivative suit against former directors of Korea First Bank by a group of minority shareholders, which resulted in damages of 40 billion won to be paid by former officials (2 presidents, a director and an auditor) to the Bank for wrongful behavior and managerial failures.

Besides these measures, the supervisory authority has decided to apply stricter standards in prudential regulation and supervision. First, banks have been ordered to engage in prompt corrective actions (PCAs) when the FSC deemed it necessary on the basis of capital adequacy ratios below stipulated levels, the composite grade of CAMELS (Capital, Asset quality, Management, Earnings, Liquidity, Sensitivity of market risk) and the individual grade of capital adequacy or of asset quality of a bank. PCA consists of three sets of progressively more stringent corrective procedures (see Table V-4).

**<Table V-4> Prompt Corrective Actions in Korea (Revised in March 1999)**

| Measures | Conditions when measures are taken | | Decision-maker | Details of Measures |
|---|---|---|---|---|
| | BIS ratio | Others | | |
| Management Improvement Recommendations | Below 8% | 1. Above the third rate in CAMELS, but below the fourth rate in terms of quality of assets or capital adequacy<br>2. It seems evident that the above cut-off conditions are not satisfied because of the large financial debacle | Governor of Financial Supervisory Board | 1. Restructuring of organization<br>2. Cost reduction<br>3. Increasing the efficiency of business unit Management<br>4. Restrictions in fixed asset investment, entry to new business, and new financial investment<br>5. Management of insolvent assets<br>6. Recapitalization<br>7. Restriction of dividend payout Special allowance for bad debts. |
| Management Improvement Requirements | Below 6% | 1. Below the fourth rate in CAMELS<br>2. It seems evident that the above cut-off conditions are not satisfied because of the large financial debacle | Governor of Financial Supervisory Board (After the FSC vote) | 1. Closure or consolidation of existing business units or restriction of new ones<br>2. Retrenchment of organization<br>3. Restriction of holding risky assets and management of assets<br>4. Restriction of deposit rate<br>5. Restructuring of subsidiaries<br>6. Requirement of management turnover<br>7. Partial suspension<br>8. Planning of M&A, or transfer of business<br>9. Measures specified in Clause 2, Article 34 of the Act Concerning Structural Improvement of Financial Industry |
| Management Improvement Orders | | 3. | | |
| | Below 2% | Unsound financial Institutions specified in Clause 3, Article 2 of the Act Concerning Structural Improvement of Financial Industry | FSC | 1. Write-off of shares<br>2. Prohibition of execution by management and nomination of manager<br>3. M&A<br>4. Suspension for less than 6 months<br>5. Transfer of contracts |

*Source:* Financial Supervisory Commission

Second, the FSC expanded the scope of regular disclosure items to the level dictated by International Accounting Standards (IAS) in order to strengthen banks' disclosure system. Third, loan classification standards as well as provisioning requirements were strengthened in accordance with international practices (see Table V-5). Also, forward-looking asset quality classification standards were introduced to commercial banks at the end of 1999. Similar standards are expected to be applied to merchant bank companies (MBCs) as of June 30, 2000. Fourth, the asset category subject to loan loss provisions was widened to include commercial papers, guaranteed bills and privately placed bonds in trust accounts. In addition, the evaluation standard for marketable and investment securities held by banks has been changed from the "lower-of-cost-or-market" method to the "mark-to-market" method.

**<Table V-5> Loan Classification Standard and Required Provisions**

| | Prior to July 1998 | Since July 1998 |
|---|---|---|
| **Definition**[1] | | |
| Normal | - | - |
| Precautionary | 3~6 month past due | 1~3 month past due |
| Substandard | More than 6 months past due, secured | More than 3 months past due, secured |
| Doubtful | More than 6 months past due, unsecured | More than 3 months past due, unsecured |
| Estimated Loss | Expected losses | Expected losses |
| **Loan loss reserve requirement** | | |
| Normal | 0.5% | 0.5% |
| Precautionary(Special mention) | 1% | 2% |
| Substandard | 20% | 20% |
| Doubtful | 75% | 75% |
| Estimated Loss | 100% | 100% |
| Provisioning for outstanding Guarantees | Not required | 20% of "substandard" 75% of "doubtful"and 100% of "estimated loss"[2] |

Note: 1) By the end of June 1999, the FSC will announce a more rigorous loan classification standard that is based on the ability of debtors to generate sufficient future cash flows rather than on their past payment histories.

2) Required from January 1999.

*Source:* Financial Supervisory Commission.

In tandem with these prudential regulations, the FSC has strengthened direct regulations with respect to exposure limits of banks and merchant banks, among others, as shown in Table V-6. First, the definition of exposures to a single borrower has been broadened to include not only the loans and payment guarantees in the conventional sense but also all direct and indirect transactions that carry credit risks such as corporate bond and CP holdings. Second, since May 1999, the combined exposure to firms affiliated with the same *chaebol* has been tightened to 25 percent of banks' capital from 45 percent. Third, the total sum of large exposures of more than 10% of bank's capital to a single borrower or the group of firms affiliated with the same *chaebol*, has been limited up to 5 times of bank's capital. Fourth, the exposures to large shareholders of banks with 10% shares or more also has been limited up to the equity shares of the large shareholders in question with maximum of 25% of bank's capital. Obviously, the main purpose of these regulations is to prevent *chaebol*-affiliated financial institutions from taking too much risks by maintaining unduly large exposures to other subsidiaries under the same *chaebol*.

**<Table V-6> Ceilings on Credit Exposures of Financial Institutions**

| | Commercial Bank | Merchant Bank Company | Insurance Company |
|---|---|---|---|
| Credit Exposures to a Single Borrower | Up to 20% of bank's capital | Up to 20% of bank's capital | |
| Combined Credit Exposures to Firms Affiliated with the Same *Chaebol* | Up to 25% of bank's capital | Up to 25% of bank's capital | Up to 3% of total assets |
| Total Sum of Large Credit Exposures | Up to 5 times of bank's capital | Up to 5 times of Bank's capital | Loans and securities holdings up to 5% of total assets, respectively |
| Credit Exposures to Large Shareholders of Financial Institutions [1)] | Up to ownership shares of the Shareholder in question with maximum of 25% of bank's capital | Up to ownership Shares of the Shareholder in question with maximum of 25% of bank's capital | |

Note: 1) Large shareholders refer to those that own 10% or more of total shares with voting rights.
*Source:* Financial Supervisory Commission

These regulations have resulted in real impact on banks' lending practices. As of the end of 1999, the total outstanding balance of large exposures – exposures that exceed 10% of bank's capital – of banks and MBCs reduced to 84.6 trillion won, down from 115 trillion won at the end of June 1999. In June 1999, Korea First Bank, Seoul Bank and LG Merchant Bank Company did not meet the limit of 500% of bank's capital. But all banks and MBCs except for Nara Merchant Bank Company were able to reduce large exposures to below the legal ceiling by the end of 1999.

**<Table V-7> Large Credit Exposures of Financial Institutions**

(Unit: trillion won, times)

| | June 1999 | | | December 1999 1) | | |
|---|---|---|---|---|---|---|
| | Equity Capital (A) | Total Sum of Large Credit Exposures (B) | B/A | Equity Capital (A) | Total Sum of Large Credit Exposures (B) | B/A |
| Banks | 52.6 | 106.3 | 2.0 | 58.9 | 78.5 | 1.3 |
| Merchant Banks | 2.8 | 8.7 | 3.1 | 2.3 | 6.1 | 2.7 |
| Total | 55.3 | 115.0 | 2.1 | 61.1 | 84.6 | 1.4 |

Note: Figures for MBCs exclude Nara Merchant Bank Company whose operation was suspended in January 2000.
*Source*: Financial Supervisory Board.

### 3. The *Chaebols* and Prudential Regulations on NBFIs

As in the case of commercial banks, institutional and legal reforms have been implemented in NBFIs in order to improve their soundness and efficiency. As pointed out earlier, the collusive and unfair relationship between the *chaebols* and the *chaebol*-affiliated NBFIs was perceived to be one of the fundamental factors that caused the financial crisis in 1997. Specifically, it has been claimed that the *chaebols*' ownership of NBFIs resulted in excessively high debt leverage of the *chaebols* and poor performance of the *chaebol*-affiliated NBFIs. Later in this section, indirect evidence in favor of such claim will be provided.

### (1) Institutional and Regulatory Reform in NBFIs

In short, regulatory standards applied to NBFIs have been upgraded to the effectively same level as that for commercial banks. For instance, a sanction mechanism was introduced to enable the supervisory authority to punish the executive and employees responsible for the insolvency of NBFIs. A prompt corrective action system and upgraded loan classification standards were introduced. Also, the appointment of outside directors and compliance officers was required while the rights of minority shareholders of NBFIs were protected at an equal strength to those of commercial banks' minority shareholders.

More important for NBFI reform, however, was the adoption of strengthened measures for governance structure designed to prevent unfair practices of NBFIs in the context of collusive relationship with the *chaebols*. To this end, governance related laws were revised significantly. For instance, prudential regulations on asset management of the *chaebol*-affiliated NBFIs were strengthened by establishing firewalls against their exposures to large shareholders of NBFIs as well as non-financial business affiliates in the same *chaebol*. The Securities Investment Trust Act was amended in such a way as to tighten investment and credit exposures of the *chaebol*-affiated NBFIs to other member firms in the same *chaebol* (from 10% of trusted assets to 7% for investment trust companies, and from 3% of total assets to 2% for insurance companies). At the same time, external auditing was mandated for large funds managed by investment trust companies (ITCs) while investors are to be provided more accurate and detailed information on the asset portfolios of the ITCs. Last but not the least, the mark-to-market system, which has been only partially applied to assets held by the ITCs, will be fully applied beginning from July 2000.

### (2) *Chaebol*-NBFIs Relations: Analysis and Implications[1]

The close links between NBFIs and the *chaebols* have created scope for conflict of interests. In fact, it appears that the *chaebols* have exploited their affiliated NBFIs as a financing arm to support and give a favor to other subsidiaries within their group in various ways: direct provision of funds, priority underwriting of securities issued by related subsidiaries, provision of preferential financial services and information on competing firms, management of related firms' shares and their prices,

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1 This section draws from Joon-Kyung Kim (1999B).

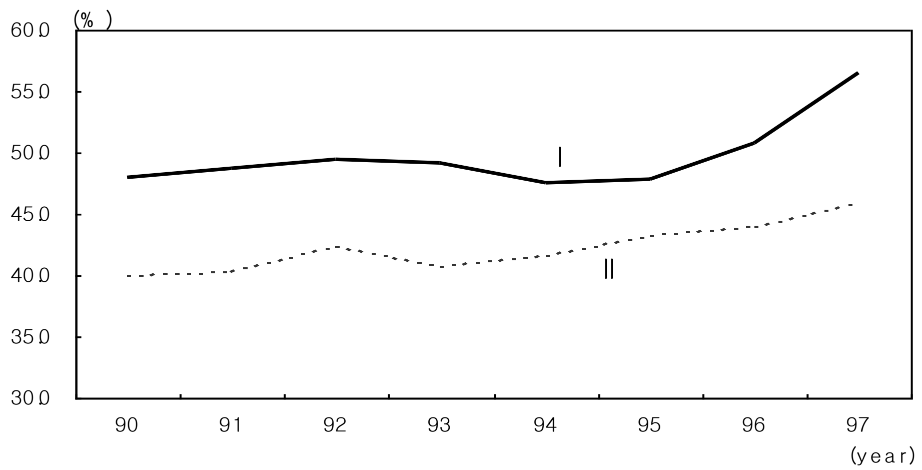
exercise of control of other firms via stock holdings, and other forms of unfair inter-group transactions. For example, the *chaebols* have been using their affiliated MBCs especially their overseas branches, to finance the activities of other subsidiaries within their groups. In this situation, it is hard to expect prudent corporate monitoring by NBFIs.

***<Corporate Leverage and Ownership of NBFIs>***

In order to analyze the linkage between the *chaebol*'s debt leverage and its ownership of NBFIs, more than 5,000 firms in the sample were divided into two groups: Group I covers those firms that own NBFIs while Group Ⅱ includes firms without any ownership in NBFIs. If one or more subsidiary companies of a *chaebol* own NBFIs, then all non-financial affiliated companies of the same *chaebol* are treated to belong to the first group. Then various financial indicators are reviewed and compared across different groups.

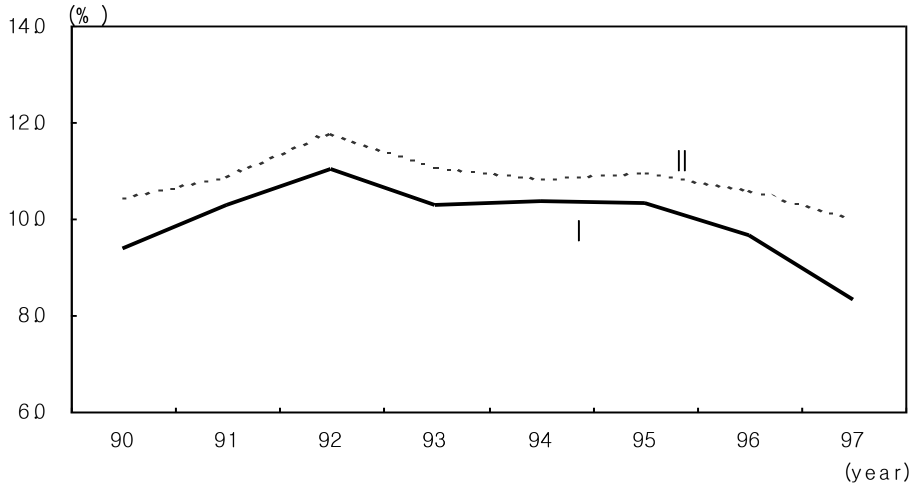
Figure V-1 presents the ratio of total borrowings to total assets for each group. It can be easily seen that Group I shows consistently higher debt leverage than Group II, and the gap between the two groups became more pronounced at the time of crisis in 1997. In addition, Group I has been favored in terms of interest costs as shown by Figure V-2, and the gap between the two groups was also widened in 1997 when Korea's credit situation was particularly tenuous due to the fear for the financial crisis.

**<Figure V-1> Total Borrowings to Total Assets for Non-Financial Firms**




Note: 1) I: Non-financial firms that own NBFIs.
II: Non-financial firms without any ownership in NBFIs.
Source: National Information and Credit Evaluation Inc.

**<Figure V-2> Interest Costs to Total Borrowings for Non-financial Firms**




Note: 1) I: Non-financial firms that own NBFIs.
II: Non-financial firms without any ownership in NBFIs.
Source: National Information and Credit Evaluation Inc.

These findings imply that *chaebol*-owned NBFIs have been functioning as a financing arm or cash vault of their affiliated subsidiaries. Particularly, the widened gap between the two groups in terms of debt leverage and interest costs at the time of the crisis can be taken as a crude evidence for the financial support to troubled subsidiaries at a favorable term.

On the basis of these findings, statistical analysis was carried out to test the hypothesis of the linkage between corporate debt leverage and NBFI ownership. In order to identify the effects of the ownership of NBFIs on corporate leverage, it is necessary to control firm-specific factors that can affect the capital structure of firms. Under this premise, the regression analysis includes firm size, the ratio of cash flows of total assets, the ratio of tangible fixed assets to total assets, and firm age as explanatory variables for the corporate leverage. The regression model also includes dummy variables for ownership of NBFIs in order to identify whether NBFIs have excessively lent to the affiliated *chaebols*.

The size of a firm, measured as the log of sales revenue, was chosen as an explanatory variable given that large and diversified business firms are likely to carry smaller default risks, and hence will have better access to external financing. This advantage tends to result in high corporate leverage. The negative correlation between cash flow and debt leverage seems to be rather obvious. A firm prefers internal funding to external borrowing given the lower funding costs of the former. In light of this, we can postulate that improved cash flows lead to the growth of retained earnings and low leverage. The size of tangible fixed assets can affect the firm's capital structure because those assets can be used as collateral for external financing. Since the provision of collateral can reduce the agency cost born by creditors, firms with large amount of tangible fixed assets will be able to borrow at a favorable term. For the inclusion of firm age variable, there are arguments supporting the prediction that younger firms will be less indebted. Younger firms have shorter credit histories – the lack of reputation in terms of creditworthiness -- which makes it more difficult for creditors to judge their quality. Younger firms also tend to be riskier since they exit more frequently. Thus we can postulate that firm age and leverage is negatively correlated. To test for age effect we construct a dummy variable, which takes the value one if age is less than or equal to three years, and zero otherwise. Finally, the pooling regression analysis in this study employs panel data over the sample period from 1990 to 1997.

The major regression results are provided in Table V-8. The regression analysis was applied for two dependent variables: total debt leverage and the share of long-term borrowing in total indebtedness. All regression results presented in the Table indicate that, even after controlling firm-specific factors, the degree of corporate leverage is positively and significantly correlated with the *chaebols*' ownership of NBFIs.

First, equation (I) in the Table employs, as an explanatory variable for the ownership of NBFIs, a dummy variable that differentiates only between ownership and non-ownership of NBFIs regardless of the business characteristics of financial institutions. All coefficients turned out to be correct in signs and statistically significant as we postulate. When another dummy variable whose value is 1 if the firms in question are *chaebol*-affiliated and 0 otherwise is added to the equation, however, the ownership dummy variable lost explanatory power.

A plausible explanation for such result is that the statistically significant effect of the ownership of NBFIs on corporate leverage in equation (I) could reflect simply the too-big-to-fail hypothesis, not the advantage of the *chaebols* directly resulting from the ownership of NBFIs. Indeed, in Korea, even those *chaebols* with no ownership of NBFIs have been able to borrow at a favorable term simply because of the pervasive moral hazard in the financial sector that relies on the too-big-to-fail hypothesis. Another explanation is a possibility of multi-colinearity problem. The fact that most *chaebols* own NBFIs suggests that the ownership dummy and the *chaebol* dummy variables are likely to be highly correlated.

Given this diagnosis, equation (II) employs three separate ownership dummy variables for each non-bank financial sector, covering MBCs, securities companies and ITCs, and insurance companies. The regression results show that the ownership dummy variables are of correct signs and statistically significant at least at 10% level for MBCs and securities companies and ITCs, while not significant for insurance companies.

**<Table V-8> Estimation of Corporate Debt Leverage**

| | Total borrowings/ Total assets | | | | Long-term borrowings/ Total borrowings | | | |
|---|---|---|---|---|---|---|---|---|
| | ( I ) | | ( II ) | | (III) | | (IV) | |
| Log sales (firm size) | 0.23 ** | (2.0) | 0.27 ** | (2.4) | 2.95 *** | (26.5) | 2.93 *** | (26.3) |
| Cash flow/total assets | -0.91 *** | (-78.6) | - 0.91 *** | (-78.7) | 0.13 *** | (11.4) | 0.13 *** | (11.4) |
| Fixed assets/total assets | 0.21 *** | (29.8) | 0.21 *** | (29.9) | 0.34 *** | (49.3) | 0.34 *** | (49.4) |
| Firm age | -3.24 *** | (-4.9) | -3.22 *** | (-4.8) | | | | |
| Ownership of NBFIs | 3.85 *** | ( 6.4) | | | 2.67 *** | (4.6) | | |
| Ownership of MBCs | | | 2.13 ** | (2.0) | | | -3.20 ** | (-3.2) |
| Ownership of Security firms·ITCS | | | 1.79 * | (1.8) | | | 5.24 *** | (5.5) |
| Ownership of Insurance firms | | | 0.83 | (0.9) | | | 0.45 | (0.5) |
| Constant | 31.5 *** | (15.8) | 30.8 *** | (15.4) | -26.7 *** | (-13.7) | -26.5 *** | (-13.5) |
| Adj. $R^2$ | 0.17 | | 0.17 | | 0.13 | | 0.13 | |
| Number of samples | 42,643 | | 42,643 | | 39,332 | | 39,332 | |

Note : 1) Estimation period : 1990~97 (annual period).
2) t-values are in parentheses. ***, ** and * indicate that the coefficient is significantly different from zero at 1, 5 and 10 percent levels respectively.
3) Firm age dummy: one if age is less than or equal to three years, and zero otherwise
4) Industrial dummy (manufacturing, construction and others) and year dummy variables are included.

Another set of regression equations were estimated in order to further investigate the effects of the ownership of NBFIs on corporate leverage by taking into account the differentiated business characteristics of NBFIs. As is well known, MBCs specialize in short-term financing such as CP discounting while securities companies and ITCs are focusing on long-term financing such as corporate bond underwriting and brokerage. Such difference in business orientation of NBFIs has an implication for the maturity profile of corporate debt. For example, it is not surprising if the *chaebols* who own MBCs have relatively high share of short-term loans in their total liability.

Equation (IV) shows that the coefficients of ownership dummy variables for MBCs and securities companies and ITCs have correct signs and are statistically significant at least at the 5% level. This result implies that the ownership by the *chaebols* of NBFIs affected not only the overall leverage but also the maturity composition of corporate debt.

***<Profitability and Soundness of NBFIs>***

The second round of analysis was carried out in order to identify whether the financial support by *chaebol*-owned NBFIs to their affiliates were profitable or not. To this end, we compare the profitability of NBFIs over two subgroups: *chaebol*-affiliated and non-*chaebol* independent NBFIs. Table V-9 shows that during 1995~97, the average rate of return on asset (ROA) of *chaebol*-affiliated NBFIs was lower than that of independent institutions by 0.1 to 1.0 percentage point.

This pattern consistently appears across all NBFIs except for insurance companies and installment credit companies as can be seen in Figure V-3. In particular, the ROAs of *chaebol*-owned securities companies and ITCs turned out to be negative with large gap compared to independent institutions. Indeed, the null hypothesis that both *chaebol*-affiliated and independent institutions carry an equal ROA was rejected at a 5% significance level. According to these results, our tentative conclusion is that the *chaebols*' ownership in NBFIs resulted in low profitability of the institutions in question.

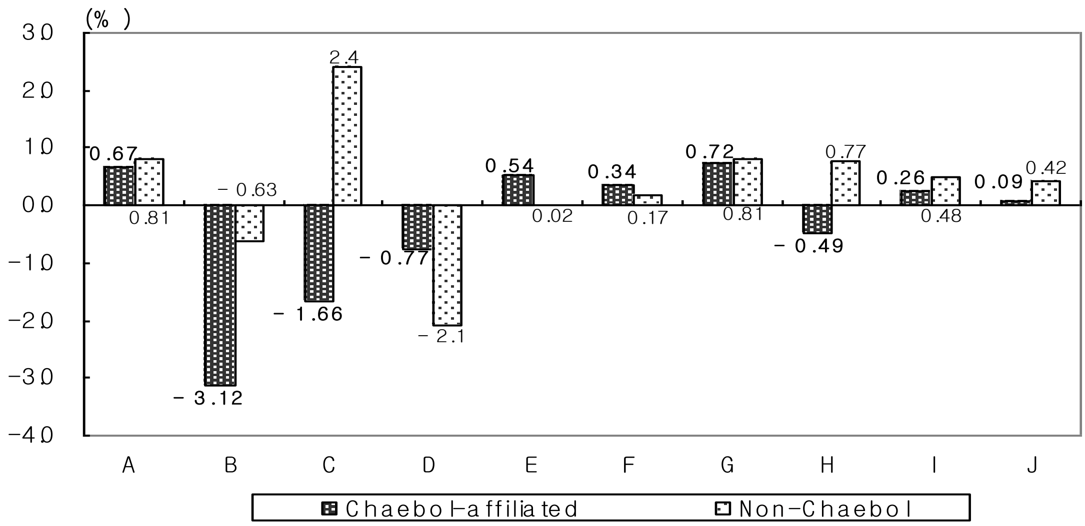
**<Table V-9> ROAs of NBFIs**

(Weighted average)

| | *Chaebol*-affiliated | Non-*Chaebol* |
|---|---|---|
| 1995 | 0.27% | 1.00% |
| 1996 | -0.68% | -0.10% |
| 1997 | -0.47% | -0.37% |

Source: National Information and Credit Evaluation Inc.

**<Figure V-3> ROAs of NBFIs by Sector (Average for 1995~ 97)**




| | | |
|---|---|---|
| A : Merchant Bank | B : Securities | C : Investment Trust Company |
| D : Life Insurance | E : Fire & Marine Insurance | F : Installment Credit |
| G : Mutual Saving & Finance | H : Venture Capital | I : Credit Card |
| J: Finance & Factoring | | |

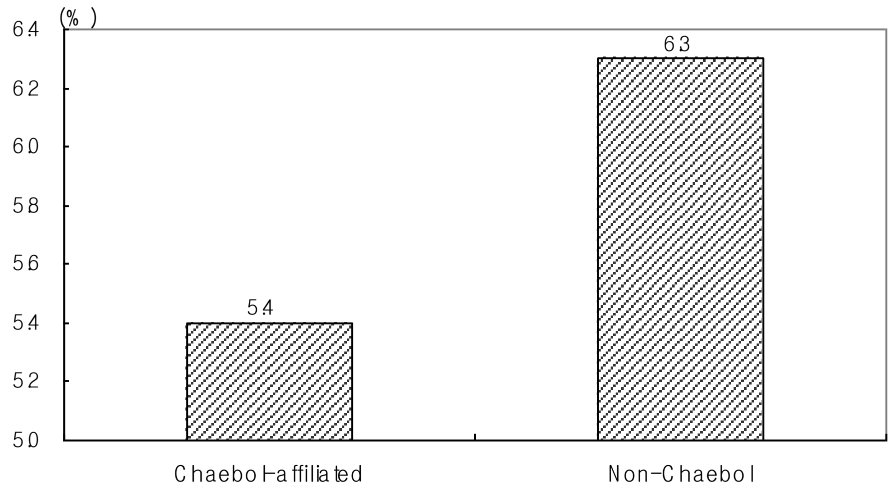
Source: National Information and Credit Evaluation Inc.

*Chaebols*' ownership of NBFIs turned out to affect not only the profitability of the NBFIs in question but also their soundness. In case of securities companies and MBCs, *chaebol*-owned institutions show relatively poor capital adequacy compared to independent institutions. Specifically, as of the end of March 1998, the average BIS ratio of *chaebol*-affiliated MBCs was 5.4%, while that of independent institutions was 6.3%. Furthermore, the net operating capital ratio of securities companies also shows similar pattern: 165% for *chaebol*-affiliated institutions versus 234% for independent institutions.

In conclusion, the apparently poor performance of *chaebol*-owned NBFIs in terms of both profitability and soundness seems to be a reflection of serious conflict of interests. External governance on debtor by these NBFIs have been neither adequate nor efficient. These institutions have acted as private cash vault of affiliated *chaebols* under their strong influence, rather than maximizing profits with commercial orientation.

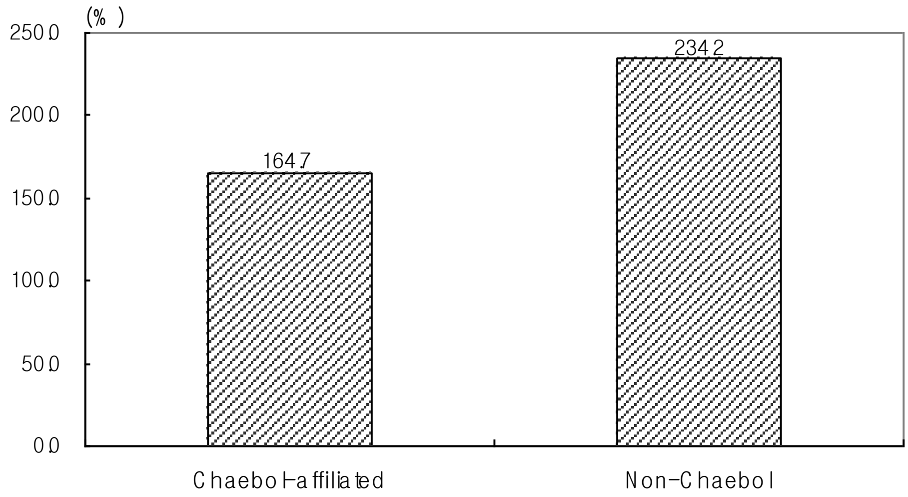
**<Figure V-4> BIS Ratio of Merchant Banking Companies**

(Weighted average, as of March 1998)




**<Figure V-5> Net Operating Capital Ratio of Securities Companies**

(Weighted average, as of March 1998)



## 4. Assessment and Implications

As summarized in the previous sections, financial sector restructuring over the two year period since the crisis have resulted in tangible progress both in terms of soundness and efficiency of the financial market. However, Korean financial sector is still facing potential systemic risks associated with large NPLs and weak capital base. Moreover, in order to achieve the full-fledged transformation of the financial sector, internal governance reform of financial institutions should translate into real changes in business practices and mindset. However, Korean financial institutions with a large exposure to troubled firms may have perverse incentives to continue forbearance policy rather than expediting the resolution of NPLs.

In this regard, strict enforcement of legal standards, particularly with respect to insolvency procedure and loss sharing principles, is essential. In addition, the role of financial institutions as an external governance device is critical in establishing an effective market discipline. To address these issues, the supervisory authority should further accelerate financial sector restructuring in terms of the disposal of NPLs, lending practices and risk management, and ultimately, the privatization of nationalized banks.

### (1) Still Large NPLs and Weak Capital Base of Financial Institutions

The disposal of NPLs in the financial sector is far from being complete. Despite the visible progress in the resolution of NPLs by KAMCO, remaining NPLs of financial institutions are still enormous by international standards. The amount of NPLs would further increase by large margin if the forward looking criteria is applied to loan classification and troubled debt of Daewoo is added to the existing figures of NPLs. Moreover, our analysis in chapter II shows that potential NPLs are also of sizable magnitude. The existence of large NPLs will continue to not only pose systemic risk to the financial market but also constrain macroeconomic policies.

Under this premise, additional injection of fiscal resources is called for in order to expedite the resolution of NPLs. However, the fiscal support for the disposal of NPLs and recapitalization should be made according to clear principles of cost minimization and fair loss sharing among involved parties. It should be noted that providing fiscal support to financial institutions cannot get around the moral hazard problem. Nonetheless, the injection of tax money can be justified on the ground that soundness, or the lack of it, of financial institutions is critical for systemic risks. Therefore, in order to prevent moral hazard problems, tax money must be mobilized only conditional upon the clear loss sharing among the involved parties and at the minimum level just sufficient to contain systemic risks at a proper level.

In this context, the supervisory authority is called for to accurately assess the fiscal needs for the rehabilitation of troubled financial institutions as well as address how to mobilize necessary resources. In this regard, it is worth of noting that the NPL resolution in the NBFIs is lagging far behind the banking sector despite the purchase by KAMCO of bad assets of more than 18 trillion won from the ITCs upon the failure of Daewoo.

In addition, prior to the second round of fiscal money injection, the authority should create a market environment conducive to market-based restructuring. To this end, the supervisory authority should enforce the partial deposit insurance system which is about to be applied beginning 2001. This policy will induce depositors to exercise caution in selecting financial institutions by taking a closer look at the financial health of the institutions. Such market forces will differentiate good banks from bad banks, and hence, will expedite financial restructuring.

### (2) Weak Market Principles and Regulatory Enforcement

Perhaps, the best cure for moral hazard problems and poor internal governance of financial institutions would be to establish strong market principles by strictly enforcing the exit of non-viable institutions. Despite the closure or suspension of about 400 financial institutions, however, many financial institutions deemed to be non-viable are still in operation. Seoul Bank is the prime example. NBFIs are no exception in this regard as can be seen in troubled ITCs and leasing companies. The supervisory authority needs to be more progressive in enforcing the exit of non-viable institutions by utilizing bad banks, staying away from a forbearance policy.

In order to establish firm standards with respect to accountability of bank management, the authority should also strictly enforce regulations and rules regarding loss sharing, not to mention risk management and unfair practices. Unfortunately, this was not the case as clearly revealed in the recent resolution of troubled ITCs at the time of Daewoo crisis. ITCs were forced to assume all losses associated with Daewoo's financial failure while investors were bailed out by the government guarantees on the redemption of Deawoo securities up to 95%. Moreover, the government decided to inject fiscal resources to two large ITCs perceived to be most troubled in the market. These measures diametrically violated the principle of fair loss sharing and risk bearing by investors, and hence, seriously aggravated moral hazard problems. Another example of unsatisfactory enforcement of loss sharing principle is the less than complete equity write-offs for insolvent financial institutions. As a result, large shareholders of financial institutions have not been fully accountable to losses.

In order to address this issue, the supervisory authority recently formulated a more strengthened rule for loss coverage by large shareholders, which has been applied as a precondition for licensing since 2000. Specifically, if large shareholders are deemed to be responsible for incurred losses, they are liable to partially make up for the losses up to 50% of net assets multiplied by their ownership shares. The penalty will be enforced in the form of equity participation or the purchase of subordinated bonds or convertible bonds issued by the financial institution in question, or KDIC bonds.

Prudential regulations on NBFIs deserve special attention in that the collusive relationship between the *chaebols* and NBFIs and related unfair practices are likely to be further signified, given the fact that the *chaebol*'s influence on NBFIs has been increasing even more rapidly since the onset of the crisis. In particular, the ITCs under the control of the *chaebols* have expanded in terms of their shares in the ITC business. Specifically, Hyundai Group and Samsung Insurance took over three troubled ITCs, one of which was ranked at the third in terms of assets. As a result, the market share of the ITCs affiliated with the top 5 *chaebols* has jumped to 31.9% by the end of 1998, up from a mere 2.8% at the end of 1997. Given the fact that the market share of the NBFIs is much larger than that of the banking sector, the increasing influence of the *chaebols* on NBFIs may pose an increased systemic risks to the financial market.

Accordingly, the supervisory authority upgraded institutional and regulatory framework on NBFIs as mentioned previously. Nevertheless, many cases of unfair practices, particularly insider trading by *chaebol*-affiated NBFIs, have been reported.

According to the FSC report, the top 4 *chaebols* turned out to receive illegal financial support of 22.1 trillion won from their affiliated NBFIs in 1998~99. Over the 8-month period from December 1998 to August 1999, Daewoo Securities Co. has provided unfair financial support to other affiliates of Daewoo Group. The daily average of the financial support provided was more than 0.7 trillion won. Seoul Investment Trust Co. where Daewoo Group has been the second largest shareholder, has also provided an unfair financial support of more than 4.8 trillion won to other Daewoo affiliates over the period from April 1998 to September 1999.

More disappointing, however, is the fact that the ex-post penalty on the NBFIs involved in illegal or unfair practices has been soft. As a result, the credibility of regulatory framework seems to be at risk. Therefore, the structural deficiencies and weakness of the financial sector will continue to undermine financial soundness and stability without an effective and strict enforcement.

Last but not the least, the supervisory authority also needs to be made liable to the neglect of duties. In this way, it would be possible to institutionally block the room for forbearance policy by the government. To this end, an institutional setup needs to be formulated to punish officers of the supervisory authority in case of lax prudential regulations and loose enforcement of PCAs.

### (3) Privatization of Banks

The potential for the government control on banks has increased significantly after the crisis as most nationwide banks were nationalized in the course of financial restructuring. Indeed, the ownership structure of nationwide banks is much more concentrated after the crisis as can be seen in Table V-10. Under this circumstance, it is hard to expect the improvement of the expertise and capacity of banks for credit evaluation if the government continues to intervene in bank management by exploiting increased ownership.

Moreover, the government ownership of banks will deter the strict enforcement of prudential regulations. Due to the ownership, the government is directly liable to losses or failures of nationalized banks, and hence, is likely to cover up the true significance of financial troubles and apply lenient regulatory standards. In other words, there exist intrinsic incentive problems as the owner of banks coincides with banks regulator. In a certain sense, this argument is a simple extension of collusive behavior of the *chaebols* and *chaebol*-affiliated NBFIs.

In light of this, the privatization of banks needs to be expedited not only to promote commercial orientation of banks but also to straighten out distorted incentive structure surrounding prudential regulation. At the same time, the privatization of banks will help recycle the already injected fiscal resources that can be used for additional financial restructuring.

In the process of privatization, the government needs to provide bidding opportunities for both foreign and domestic investors alike. In fact, foreign participation in the domestic banking industry will promote learning and help improve internal governance structure as can be seen in the cases of Korea First Bank, Korea Exchange Bank, Kookmin Bank and Korea Housing Bank which attracted foreign investment.

**<Table V-10> Large Shareholders' Ownership of Banks (As of the end of 1998)**

| Classification | Large Shareholders Over 1% | | Large Shareholders Over 4% | |
|---|---|---|---|---|
| | Number | Ownership Share (%) | Number | Ownership Share (%) |
| Chohung | 8(3) | 19.8( 7.3) | 1(1) | 4.5( 4.5) |
| Hanvit | 2(0) | 97.0( 0.0) | 1(0) | 94.8( 0.0) |
| Korea First | 2(0) | 93.8( 0.0) | 2(0) | 93.8( 0.0) |
| Seoul | 2(0) | 93.8( 0.0) | 2(0) | 93.8( 0.0) |
| Korea Exchange | 4(1) | 68.2( 1.2) | 2(0) | 66.0( 0.0) |
| Kookmin | 12(3) | 36.3( 6.0) | 3(0) | 20.5( 0.0) |
| Housing & Commerical | 6(1) | 36.5( 4.5) | 3(1) | 30.5( 4.5) |
| Shinhan | 7(3) | 11.6( 5.2) | 0(0) | 0.0( 0.0) |
| KorAm | 13(5) | 68.4(41.0) | 3(2) | 53.5(33.7) |
| Hana | 16(9) | 55.7(34.4) | 8(5) | 43.4(27.4) |
| Peace | 16(4) | 43.1(10.4) | 1(0) | 5.0( 0.0) |
| Nationwide Banks, average | 8(3) | 56.7(10.0) | 2(1) | 46.0 ( 6.4) |
| Daegu | 4(1) | 15.9(12.1) | 1(1) | 9.1( 9.1) |
| Pusan | 3(2) | 21.1(17.3) | 1(1) | 15.1(15.1) |
| Kwangju | 6(4) | 21.1(16.4) | 1(1) | 11.4(11.4) |
| Cheju | 4(2) | 61.5(58.4) | 1(1) | 57.3(57.3) |
| Jeonbook | 11(6) | 54.4(30.9) | 6(3) | 41.7(22.5) |
| Kangwon | 7(1) | 33.0(12.9) | 3(1) | 24.4(12.9) |
| Kyungnam | 9(4) | 24.3(16.6) | 2(2) | 10.9(10.9) |
| Chungbuk | 10(4) | 38.4(23.2) | 3(2) | 27.0(19.7) |
| Local Banks, average | 7(3) | 34.0(23.5) | 2(2) | 24.6(19.9) |
| Commercial Banks, average | 12(3) | 47.0(19.8) | 3(1) | 36.9(12.1) |

Note: Figures in parentheses indicate the number and ownership share by private industrial capital (including affiliated financial institutions).

* Government owns 46.88% of Korea First Bank, 46.88% of Seoul Bank and KDIC owns 94.75% of Hanvit Bank and 6.88% of Korea First Bank and Seoul Bank respectively.

*Source*: Bank Supervisory Board.

# VI. Conclusion

Korean *chaebols* are in transition. After many attempts at corporate restructuring, the *chaebols* are finally showing signs of real change in corporate governance and in their relationship to the financial institutions. The strong mandate by the IMF and the government, and the *chaebol*'s internal need for reform in order to survive, made this round of corporate restructuring more successful than past ones.

The study's findings revealed that quantitative indicators of the *chaebols* have improved significantly. For example, after showing extremely high debt-equity ratios of over 500% in recent years, the largest four *chaebols* have successfully reduced their debt-equity ratios to below 200% by the end of 1999. Intra-*chaebol* debt guarantees of the thirty largest *chaebols* have decreased significantly. At the same time, many large-scale business mergers and swaps have resulted in streamlining business activities in the largest *chaebols* with a significant reduction in the number of member firms.

Survey findings also showed that the corporate governance structure is changing, albeit changes are still too early to be captured fully. For example, only 5% of the CEOs in the 1999 survey were directly related to the founder, while that figure was 30% in the 1992 survey. The 1999 survey showed that over three-quarters of the CEOs were recruited from within the firm, implying a significant improvement in terms of recruiting and promoting professional managers. Another finding from the survey is that financial support across affiliates within the same *chaebol* still seems to continue, although the degree of centralized management decision making has weakened significantly. In comparison, the 1992 survey showed that the mother firm acted not only as a provider of capital and technology but also as a key decision-making unit for the group as a whole.

Korea's financial sector has undergone even more intensive restructuring. About 400 institutions were either closed or suspended, while the employment of the banking sector decreased by more than 25%. Thanks to the injection of fiscal resources, many Korean banks have regained capital adequacy with BIS ratios of more than 8%. In addition, the regulatory framework of prudential supervision was greatly upgraded with the introduction of global standards with respect to loan classification and capital provisioning.

Despite such substantial progress, however, Korea still faces an enormous challenge in restructuring both the corporate and financial sectors. Total indebtedness of the corporate sector remains effectively unchanged, although the reported debt-equity ratios of *chaebols* fell significantly. Similarly, Korea's financial sector still suffers from the sizable amount of potential NPLs although NPLs were substantially resolved and naturally decreased due to economic recovery. As a result, the economy will continue to be vulnerable to cyclical shocks and prone to increased financial and macroeconomic instability.

Business restructuring, particularly Big Deals among large *chaebols*, may lead to an increased concentration of economic power as they further reinforce *chaebols*' monopolistic position in the market. Although corporate workout programs have produced relatively successful results compared to other restructuring measures, they have often been delayed and disorganized due to moral hazard problems on the parts of both *chaebols* and their creditor banks. Creditor banks may have perverse incentives to bail out troubled client firms rather than to strictly enforce restructuring measures due to the fear of further increase in NPLs and the erosion in their capital base. At the same time, the owners of *chaebols* are less inclined to accept debt-equity swaps because of their strong motivation to retain managerial control.

Last but not the least, despite unprecedented reform in corporate governance, the chairs of the major *chaebols* have remained the same since the financial crisis. Although the chair's perceived influence in the selection of the board of directors decreased from 40.3% in 1992 to 32.5% in 1999 according to the survey results, it is unmistakable that the chair continues to play an important role as demonstrated in the Hyundai *chaebol*'s recent succession crisis.

As to financial restructuring, the nationalization of most banks, which were perceived to be somewhat inevitable in the course of restructuring, may turn out to be counterproductive in establishing firm market principles. Due to the nationalization of banks, the government control on bank management is no longer a remote possibility. More critical is the likelihood of inadequate supervision and regulation on the nationalized banking sector, due to the conflict of interests that arise from the fact that the owner of banks coincides with the regulator.

The non-bank financial sector has not yet solved the inherent problems of collusive relationship between *chaebols* and NBFIs. In fact, *chaebols*' influence on NBFIs did not shrink but increase after the crisis in accordance with the increased *chaebol* ownership of ITCs and insurance companies, among others. Accordingly, the intrinsic risks of investment failure are likely to persist, if not increase. Moreover, heavy insider-trading and unfair practices of NBFIs, which were uncovered in relation with Daewoo's failure, imply that there has been little improvement in internal governance of financial institutions in spite of strengthened firewalls.

In sum, there are more challenges to overcome than what have already been achieved in Korea's corporate and financial restructuring. Tangible improvements in the corporate structure and governance to date have yet to be translated into real gains in productivity and transparency. Also, it should be noted that it takes time for business practices and mindset to change in any meaningful sense. In this regard, strict enforcement of legal standards and market principles should be in order. In addition, the role of financial institutions and the supervisory authority as an external governance device is critical in establishing an effective market discipline.

Given these assessments, corporate and financial restructuring on an ongoing basis is called for in order for Korea to adapt itself swiftly to dramatic changes in business environment in line with market opening and globalization.

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## Appendix A

## INTERVIEW QUESTIONNAIRE

### CORPORATE GOVERNANCE, FINANCE AND RESTRUCTURING IN SOUTH KOREA'S *CHAEBOL*: CHANGES SINCE THE FINANCIAL CRISIS OF 1997

- Interview Time: 1999, Month ____, Date ____.    From ___ AM/PM -- To ___ AM/PM
- Interviewer Name: _______________
- Respondent's Name: ________________
- Respondent's Position:

1. General Manager
2. Director of Planning and Coordination
3. Chief Secretary
4. Other: _______________

### Company Profile

- Company I. D. No.: ___________
- Company Name: ___________
- Company Location: ___________
- Form of Enterprise: (Check one, and specify.)

1. State owned
2. Joint-venture between state and private enterprise (Specify share: ______________)
3. Joint-venture between foreign enterprise and local private enterprise (Specify share: ______________)
4. Joint venture between foreign enterprise and state enterprise (Specify share: ______________)
5. Private firm without joint-venture
6. Others: _______________.

- Major stock holders:

| | Relationship of the stockholders | Share |
|---|---|---|
| 1. | ________________________ | _____ % |
| 2. | ________________________ | _____ % |
| 3. | ________________________ | _____ % |
| 4. | ________________________ | _____ % |
| 5. | ________________________ | _____ % |

(E.g., Founder's family, affiliates, domestic banks, foreign banks, etc.)

## I. Ownership and Management

1. How many members are on the board of directors?

| Managing director | Outside director |
|---|---|
| ① 1 to 5 | ① 0 |
| ② 6 to 10 | ② 1 to 5 |
| ③ 11 to 15 | ③ 6 to 10 |
| ④ 16 to 20 | ④ 11 to 15 |
| ⑤ 21 to 25 | ⑤ 16 to 20 |
| ⑥ 26 to 30 | ⑥ 21 to 25 |
| ⑦ 31 to 35 | ⑦ 26 to 30 |

➢ List the names of Outside directors and their social positions.

___________________________________

___________________________________

___________________________________

___________________________________

2. Who plays the most influential role in the selection of the board of directors?

① Government

② Stockholders

③ Chief executive officer of the firm

④ Chair of the *chaebol*

⑤ Financial institution

⑥ Client firm

⑦ Other: __________

3. What is the background of the chief executive officer of the firm?

① Founder of the *chaebol*

② Second or third generation of the founder of the *chaebol*

③ Promotion within the firm

④ Recruited from the government

⑤ Recruited from another corporation

⑥ Recruited from financial institution

⑦ Other: __________

4. Does the founder's family work in your firm?

① Yes (Go to Question 5)

② No (Go to Question 7)

5. Please rank the two most important reasons for hiring founder's family members.

First: _______________ Second: _______________

① Family members are more trustworthy than strangers.

② For ease of inheritance of family business.

③ For ease of control and management of member firms.

④ Family members are the best qualified for their positions.

⑤ Other: _______________________________.

6. Are there any differences regarding salary, promotion and opportunities for education and training between the founder's family members and others?

① Same

② Higher (better) for family

③ Low (more difficult) for family

7. Please rank the two most important reasons for NOT hiring the founder's family members.

First: _______________ Second: _______________

① There was no need to consider hiring founder's family.

② Special managers are more competent in business than the family members of the founder.

③ Special managers are more qualified than the family members of the founder.

④ Hiring founder’s family undermines the support of the stockholders of the firm.

⑤ Other: ______________________________

## II. *Chaebol*

8. Which member firm in your business group has managerial influence on your firm? Please specify the name and its relationship with your firm.

- Name:_________________________
- Relationship:_____________________

9. How does the firm influence your firm's management? (Please, specify the percentage if your answer is number one).

① The firm invests capital ( _________ %)
② The firm provides technology
③ The firm guides management of the firm
④ The firm makes personnel decisions of the firm
⑤ Others:_____________________

10. Specify the name of the firm if your firm has the following cooperative relationship with any member firm in your business group.

| Type of cooperation | Name of member firm | Relations | Direction | |
|---|---|---|---|---|
| | | | Offer | Accept |
| Exchange of managers | | | | |
| Exchange of workers | | | | |
| Mutual investment | | | | |
| Cross payment guarantee | | | | |
| Joint development & utilization of technology (i.e., Joint R&D) | | | | |
| Others:_____________ | | | | |

11. What are the two greatest advantages of being a member firm of the *chaebol*? (Rank order the advantages)

First:_________________ Second:_________________

① Stable supply of parts and material
② Stable sales of products
③ Facilitated adjustment to market fluctuations
④ Social prestige
⑤ Others:______________________

12. What percentage of your purchase and sales were from/to other firms in your *chaebol* in 1997 and 1998, respectively? (Rank in terms of the amount of purchase and sales)

| | 1997 | | | 1998 | | |
|---|---|---|---|---|---|---|
| Rank | Name of the firm | Purchase amount (%) | Sales amount (%) | Name of the firm | Purchase amount (%) | Sales amount (%) |
| 1 | | | | | | |
| 2 | | | | | | |
| 3 | | | | | | |

13. (Question for manufacturing firms) What are the approximate shares of your firm's domestic sales and export through the following company in 1998? (Specify the percentage in terms of the amount of domestic sales or export respectively)

| | Domestic Sale (%) | Export (%) |
|---|---|---|
| General trading company | | |
| Direct sales | | |
| Other marketing networks | | |

14. Please specify the company from which you receive or offer technology transfer(s); country, the time period, the nature of the technology; the amount; and your company's relationship to the provider company.

| | Direction of transfer | Name of Company | Country | The time period | Technology | Amount ($) | Relationship |
|---|---|---|---|---|---|---|---|
| 1 | | | | | | | |
| 2 | | | | | | | |
| 3 | | | | | | | |

- Type of relationship with the provider company: (1) Company in the same *chaebol*; (2) Subcontractor; (3) Joint venture partner; (4) Foreign subsidiary; Please indicate all that apply, and specify if other.
- Direction of transfer: Please, describe whether you offered or received technology.

## III. Reform

15. Who is responsible for making decisions about your firm's restructuring program?

① Board of directors
② Shareholders
③ CEOs and top managers
④ Taskforce in charge of corporate restructuring within your firm
⑤ Government agencies
⑥ Others:_______________

16. What are the main purposes of you firm's restructuring in rank order?

First:_______________ Second:_____________

① Down-sizing
② Streamlining business activities
③ Improving transparency in decision-making
④ Improving financial situation
⑤ Upgrading business activities
⑥ Others:____________

17. What are the two most expected outcomes of your firm's restructuring efforts in rank order?

First:_______________ Second:_____________

① Down-sizing
② Streamlining business activities
③ Improving transparency in decision-making
④ Improving financial situation
⑤ Upgrading business activities
⑥ Others:____________

18. What are the biggest impediments against your firm's restructuring? If more than one, rank them.

First:_______________ Second:_____________

① Government regulations
② Incompatibility to the restructuring guidelines of the entire *chaebol*
③ Inter-firm's conflicts within the *chaebol*
④ Resistance from the labor union
⑤ Improving financial situation
⑥ Others:_____________________________

19. Select and rank order the three most influential groups in the decision-making process before and after the restructuring.

| | | Before Restructuring | After Restructuring |
|---|---|---|---|
| ① | Shareholders | ______ | ______ |
| ② | CEO's | ______ | ______ |
| ③ | Board of Directors | ______ | ______ |
| ④ | Middle Managers | ______ | ______ |
| ⑤ | Government | ______ | ______ |
| ⑥ | Suppliers | ______ | ______ |
| ⑦ | Workers | ______ | ______ |
| ⑧ | Customers | ______ | ______ |
| ⑨ | Interest Group | ______ | ______ |
| ⑩ | General Public | ______ | ______ |

20. What is the proportion of total employees who lost their job due to the restructuring program?

- Office worker:________________(%)
- Technical worker:________________(%)

21. What are the prevailing internal opinions within your firm about your firm's restructuring efforts?

① Restructuring is necessary and is being adequately implemented.

② Restructuring is necessary, but is not being adequately implemented.

③ Restructuring is unnecessary.

22. Describe some of the changes that have occurred and how they "positively" or "negatively" influenced the firm's well being.

________________________________________________________________________________

________________________________________________________________________________

________________________________________________________________________________

________________________________________________________________________________

________________________________________________________________________________

## Appendix B

## Sampling Frame and Sample

| *Chaebol* | Member Firms of the *Chaebol** | |
|---|---|---|
| **Hyundai (53)**** | Diamond AD Ltd. | ✓ |
| | Kia International Trade Co., Ltd. | |
| | Taewha Shopping | |
| | Kia Precision Works Co., Ltd. | |
| | T. Zone Korea Co., Ltd. | ✓ |
| | KEFICO Corporation | |
| | Chip Pack Korea Co. | |
| | Diamaond Baits Co., Ltd. | |
| | AB System Korea Co., Ltd. | |
| | Hyundai Research Institute | |
| | Hyundai Mipo Dockyard Co., Ltd. | |
| | Hyundai Asan Corporation | |
| | Hyundai Unicons Baseball Club | |
| | Korea Industrial Development Co., Ltd. | |
| | Kia Motech Co., Ltd. | |
| | Kia Motors Corporation | |
| | Kia Electronics & System Co., Ltd. | |
| | Union System Inc. | |
| | Kia Heavy Industry Co. | |
| | Aluminum of Korea Co., Ltd. | |
| | East Sea Shipping Co., Ltd. | |
| | Inchon Airport Terminal | |
| | Inchon Iron and Steel Co., Ltd. | |
| | Korea Soviet Shipping Co., Ltd. | |
| | Hyundai Pipe Co., Ltd. | |
| | Hyundai Engineering & Construction Co., Ltd. | ✓ |
| | Hyundai Logistics Co., Ltd. | ✓ |
| | Hyundai Semicon Co., Ltd. | |
| | Hyundai Broadcasting System | |
| | Hyundai Merchant Marine Co., Ltd. | ✓ |
| | Hyundai Petrochemical Co., Ltd. | |
| | Hyundai Sega Entertainment Co., Ltd. | ✓ |
| | Hyundai Energy Co., Ltd. | ✓ |
| | Hyundai Elevator Co., Ltd. | |
| | Hyundai Space & Aircraft Co., Ltd. | |

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|---|---|---|
| | Hyundai Motor Company | ✓ |
| | Hyundai Electronics Industries Co., Ltd. | ✓ |
| | Hyundai Precision & Industry Co., Ltd. | ✓ |
| | Hyundai Information Technology Co., Ltd. | |
| | Hyundai Oil Refinery Co., Ltd. | |
| | Hyundai Corporation | ✓ |
| | Hyundai Heavy Industries Co., Ltd. | |
| | Hyundai Securities Co., Ltd. | |
| | Hyundai Investment Trust & Securities Co., Ltd. | |
| | Kang Eun Mutual Savings & Finance Co., Ltd. | |
| | Hyundai Futures Corporation | |
| | Hyundai Capital Corporation | |
| | Kia Finance Co., Ltd. | |
| | Ulsan Merchant Banking Corporation | |
| | Hyundai Corporation Finance Co. | |
| | Hyundai Capital Service, Inc. | |
| | Hyundai Investment Management Co., Ltd. | |
| | Kangwon Bank | |
| **Daewoo (27)** | Daewoo Automotive Components Ltd. | |
| | Daewoo Corporation | ✓ |
| | Daewoo Development Co., Ltd. | |
| | Daewoo Electic Motor Industries Ltd. | |
| | Daewoo Electronics Co., Ltd. | |
| | Daewoo Electonics Components Co., Ltd. | |
| | Daewoo Moter Service Co., Ltd. | ✓ |
| | Daewoo Electronics Service Co., Ltd. | |
| | Daewoo Heavy Industries Ltd. | |
| | Daewoo Information System Co, Ltd. | |
| | Daewoo Leisure Co., Ltd. | |
| | Daewoo Motor Co., Ltd. | |
| | Daewoo Motor Sales Co., Ltd. | |
| | Daewoo Telecom Ltd. | |
| | Daewoo-ST Semiconductor Design Ltd. | |
| | Hankuk Electric Glass Co., Ltd. | |
| | Kyeangnam Enterprises Ltd. | |
| | Orion Electrics Co., Ltd. | |
| | Ssang Yong Motor Co., Ltd. | |
| | Yu-Hwa Development Co., Ltd. | |
| | Daewoo Capital Co., Ltd. | |
| | Daewoo Capital Management Co., Ltd. | |
| | Daewoo Futures Co., Ltd. | |
| | Daewoo Securities Co., Ltd. | |
| | Daewoo Venture Capital Co., Ltd. | |
| | The Diners Club of Korea | ✓ |
| | Koram Plastic Co., Ltd. | |

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| **Samsung (47)** | Novita Co. | |
| | Daegyung Building Co., Ltd. | |
| | Samsung Economic Research Institute Co. | |
| | Samsung Lions. Co. Ltd. | |
| | Security No. 1 Corp Co., Ltd. | |
| | Cheil Communications Inc. | ✓ |
| | Cheil Bozell Corporation Co., Ltd. | |
| | The Shilla Hotels & Resorts Co., Ltd. | |
| | Daehan Fine Chemicals Co. | |
| | Moojin Development Co. | |
| | Samsung Kwangju Electronics Co., Ltd. | |
| | Samsung Co., Ltd. | ✓ |
| | Samsung Commercial Vehicle Co., Ltd. | |
| | Samsung Petro Chemical Co., Ltd. | |
| | Samsung Futures Co., Ltd. | |
| | Samsung Watch Co., Ltd. | |
| | Samsung Everland Co., Ltd. | |
| | Samsung SDS Co., Ltd. | |
| | Samsung Engineering Co., Ltd. | ✓ |
| | Samsung Motor Co., Ltd. | |
| | Samsung Electronic Devices Co., Ltd. | ✓ |
| | Samsung Electro-Mechanics Co., Ltd. | |
| | Samsung Electronics Co., Ltd. | ✓ |
| | Samsung Electronic Service Co., Ltd. | |
| | Samsung Fine Chemicals Co., Ltd. | |
| | Samsung General Chemicals Co., Ltd. | |
| | Samsung Heavy Industries Co., Ltd. | ✓ |
| | Samsung Corning Co., Ltd. | |
| | Seoul Corning and Fine Glass Co., Ltd. | |
| | Samsung Aerospace Industries. Inc. | |
| | Samsung Fire and Damage Service Co. | |
| | STECO. Co. | |
| | STECOM. Co. | |
| | A-San Electronics Co., Ltd. | |
| | Cheil Wool Textile co., Ltd. | |
| | D.N.S. Korea Co., Ltd. | |
| | Handuck Chemical Co. | |
| | Samsung Life Insurance Co., Ltd. | ✓ |
| | Samsung Fire & Marine Insurance Co., Ltd. | ✓ |
| | Samsung Securities Co., Ltd. | |
| | Samsung Investment Trusts Co. Ltd. | |
| | Samsung Cards Co., Ltd. | |
| | Samsung Capital Co., Ltd. | |
| | Samsung Investment Management Co., Ltd. | |
| | Samsung Life Investment Management Co., Ltd. | |

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| | Samsung SDI Co., Ltd. | |
| | Seoul Commtech Co., Ltd. | |
| **LG (41)** | SILTRON Co., Ltd. | |
| | Hanmoo Development Co., Ltd. | |
| | LG Engineering and Construction Corporation | ✓ |
| | LG Economic Research Center | ✓ |
| | LG Micron Co., Ltd. | |
| | LG Department Store Co., Ltd. | |
| | LG Ad. Inc. | |
| | LG Mart Co., Ltd. | |
| | LG EDS Systems Inc. | ✓ |
| | LG Internet Co., Ltd. | |
| | LG International Corporation | |
| | LG Sports Co., Ltd. | |
| | LG Home Shopping Inc. | |
| | LG Chemical, Ltd. | |
| | Kuk Dong City Gas Co., Ltd. | |
| | LG Construction Co., Ltd. | ✓ |
| | LG and Dawoo Polycabonate Co., Ltd. | |
| | LG Industrial System Co., Ltd. | ✓ |
| | LG Electro-Components Ltd. | ✓ |
| | LG Petrochem Co., Ltd. | ✓ |
| | LG Energy Co., Ltd. | |
| | LG Engineering Co., Ltd. | |
| | LG LCD Co., Ltd. | |
| | LG MMA | ✓ |
| | LG Electronics Inc. | |
| | LG Cable Ltd. | |
| | LG Electronic Service Inc. | ✓ |
| | LG Information & Communications Ltd. | |
| | LG-Caltex Gas Co., Ltd. | |
| | LG Hitachi Ltd. | |
| | Hoyu Tanker Co., Ltd. | |
| | LG Precision Co., Ltd. | |
| | LG Fire & Marine Insurance Co., Ltd. | |
| | LG Securities Co., Ltd. | |
| | LG Merchant Banking Corporation | |
| | Mirae Credit Information Co., Ltd. | |
| | LG Futures Co., Ltd. | |
| | LG Capital Co., Ltd. | |
| | Bu Min Mutual Saving’s and Finance Co., Ltd. | |
| | LG Venture Investment Co., Ltd. | |
| | LG Telecom Co., Ltd. | |

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| **SK (36)** | Busan City Gas Co., Ltd. | |
| | Chungju City Gas Co., Ltd. | |
| | Daehan City Gas Co., Ltd. | |
| | Dahan City Gas Engineering Co., Ltd. | |
| | Jungboo City Gas Co., Ltd. | |
| | Koomi City Gas Co., Ltd. | |
| | Pohang City Gas Co., Ltd. | |
| | Pusan City Gas development Co., Ltd. | |
| | SK Chemical Co., Ltd. | ✓ |
| | SK Construction Co., Ltd. | |
| | SK Co, Ltd. | ✓ |
| | SK Distribution Co., Ltd. | ✓ |
| | SK Energy Sale Co., Ltd. | ✓ |
| | SK Gas. Ltd. | |
| | SK Global Co., Ltd. | |
| | SK NJC Co., Ltd. | |
| | SK Oxy Chemical Co., Ltd. | |
| | SK Shipping Co., Ltd. | |
| | SK Telecom Co., Ltd. | ✓ |
| | SK Teletex Co., Ltd. | ✓ |
| | SK Telink Co., Ltd. | ✓ |
| | SK UCB Co. | |
| | SK UCD Co., Ltd. | |
| | SK ENRON Co., Ltd. | |
| | SK Forest Co., Ltd. | |
| | SKC Ltd. | |
| | Sheraton Walker Hill | |
| | Stella Shipping Co. | |
| | Taegu Electric Power Co. | |
| | Yangsan International Mart Co., Ltd. | |
| | ERIDEUM Korea Co., Ltd. | |
| | SK Life Insurance Co., Ltd. | ✓ |
| | SK Securities Co., Ltd. | |
| | SK Capital Co., Ltd. | |
| | SK Investment Trust Co., Ltd. | |
| | SK C&C Co., Ltd. | |

Notes: * A check mark (✓) denotes the firms, which participated in the 1999 survey.

** The numbers inside the parenthesis are the numbers of firms in each *chaebol*.

4. What are the reasons for hiring founder’s family members? (Unit: Percentage)

| Value Label | 1992 | 1999 | |
|---|---|---|---|
| 1. Family members are more trustworthy than strangers | 16.2 | 15.4 | 18.2 |
| 2. Ease of inheritance of family business | 44.1 | 38.5 | 27.3 |
| 3. Ease of control and management of member firms | 20.6 | 23.1 | 31.8 |
| 4. Family members were the best qualified for their positions | 14.7 | 15.4 | 13.6 |
| 5. Others | 4.4 | 7.7 | 9.1 |
| Total | 100.0 | 100.0 | |

5. Are there any differences regarding salary, promotion and opportunities for education and training between the founder’s family members and others? (Unit: Percentage)

| Value Label | 1999 |
|---|---|
| 1. Same | 30.8 |
| 2. Higher for family | 69.2 |
| 3. Lower for family | 0.0 |
| Total | 100.0 |

6. What are the reasons for not hiring founder’s family members? (Unit: Percentage)

| Value Label | 1999 |
|---|---|
| 1.There was no need to consider hiring founder’s family | 51.3 |
| 2. Special managers are more competent in business than the family members of the founder | 15.4 |
| 3. Special managers are more qualified than the family members of the founder | 17.9 |
| 4. Hiring founder’s family undermines the support of the stockholders of the firm | 5.1 |
| 5. Others | 10.3 |
| Total | 100.0 |

9. How does the firm [which has management influence on your firm] influence your firm's management? (Unit: Percentage)

| Value Label | 1992 * | 1999 ** |
|---|---|---|
| 1. Invest capital | Yes : 73.9<br>No : 26.1 | 51.6 |
| 2. Provide technology | Yes : 18.8<br>No : 81.2 | 6.5 |
| 3. Guide management | Yes: 37.7<br>No: 62.3 | 9.7 |
| 4. Make personnel decisions | Yes: 24.6<br>No: 75.4 | 6.5 |
| 5. Others | -- | 25.8 |
| Total | | 100.0 |

Note: *The role of the mother firms

**The role of the most influential firm

11. What are the two greatest advantages of being a member firm of the *chaebol*? (Unit: Percentage)

| Value Label | First | Second |
|---|---|---|
| 1. Stable supply of parts and material | 28.9 | 22.6 |
| 2. Stable sales of products | 31.6 | 32.3 |
| 3. Facilitated adjustment to market fluctuations | 10.5 | 29.0 |
| 4. Social prestige | 28.9 | 9.7 |
| 5. Others | 0.0 | 6.5 |
| Total | 100.0 | 100.0 |

15. Who is responsible for making decisions about your firm's restructuring program? (Unit: Percentage)

| Value Label | 1999 |
|---|---|
| 1. Board of directors | 8.3 |
| 2. Shareholders | 2.8 |
| 3. CEOs and top managers | 47.2 |
| 4. Taskforce in charge of corporate restructuring within your firm | 30.6 |
| 5. Government agencies | 0.0 |
| 6. Business Group | 8.3 |
| 7. Others | 2.8 |
| Total | 100.0 |

16. What are the main purposes of your firm's restructuring? (Unit: Percentage)

| Value Label | First | Second |
|---|---|---|
| 1. Down-sizing | 5.9 | 6.3 |
| 2. Streamlining business activities | 0.0 | 3.1 |
| 3. Improving transparency in decision-making | 2.9 | 0.0 |
| 4. Improving financial situation | 44.1 | 34.4 |
| 5. Upgrading business activities | 41.2 | 50.0 |
| 6. Others | 5.9 | 6.3 |
| Total | 100.0 | 100.0 |

17. What are the two most expected outcomes of your firm's restructuring efforts? (Unit: Percentage)

| Value Label | First | Second |
|---|---|---|
| 1. Down-sizing | 14.7 | 17.2 |
| 2. Streamlining business activities | 5.9 | 0.0 |
| 3.Transparency in decision-making | 2.9 | 0.0 |
| 4. Improving financial situation | 41.2 | 51.7 |
| 5. Upgrading business activities | 29.4 | 31.0 |
| 6. Others | 5.9 | 0.0 |
| Total | 100.0 | 100.0 |

18. What are the biggest impediments against your firm's restructuring?(Unit: Percentage)

| Value Label | First | Second |
|---|---|---|
| 1. Government regulations | 15.2 | 4.5 |
| 2. Incompatibility to the restructuring guideline of the entire *chaebol* | 6.1 | 13.6 |
| 3. Inter-firm's conflicts within the *chaebol* | 6.1 | 13.6 |
| 4. Resistance from the labor union | 36.4 | 13.6 |
| 5. Improving financial situation | 15.2 | 31.8 |
| 6. Others | 21.2 | 22.7 |
| Total | 100.0 | 100.0 |

## Appendix C

## SELECTED TABULATION OF QUESTIONNAIRE FINDINGS

1. How many members are on the board of directors? (Unit: Percentage)

| Value Label | 1992 | 1999 | 1999 |
|---|---|---|---|
| | | Managing directors | Outside directors |
| 1. 0 | - | - | 54.1 |
| 2. 1-5 | 40.1 | 35.0 | 43.2 |
| 3. 6 – 10 | 40.4 | 32.5 | 2.7 |
| 4. 11 – 15 | 8.4 | 15.0 | 0 |
| 5. 16 – 20 | 3.8 | 10.0 | 0 |
| 6. 21 – 25 | 1.8 | 5.0 | 0 |
| 7. 26 – 30 | 2.1 | 0.0 | 0 |
| 8. 31 – 35 | 1.3 | 2.5 | 0 |
| 9. 36 or more | 2.1 | 0 | 0 |
| Total | 100.0 | 100.0 | 100.0 |

2. Who plays the most influential role in the selection of the board of directors? (Unit: Percentage)

| Value Label | 1992 | 1999 |
|---|---|---|
| 1. Government | 0.3 | 0.0 |
| 2. Stockholders | 35.0 | 22.5 |
| 3. C.E.O. of the firm | 22.4 | 42.5 |
| 4. Chair of the *chaebol* | 40.3 | 32.5 |
| 5. Financial institution | 0 | 0 |
| 6. Client firm | 0 | 0 |
| 7. Others | 2.0 | 2.5 |
| Total | 100.0 | 100.0 |

3. What is the background of the chief executive officer of the firm? (Unit: Percentage)

| Value Label | 1992 | 1999 |
|---|---|---|
| 1. Founder of the *chaebol* | 18.3 | 0.0 |
| 2. Second or third generation of the founder of the *chaebol* | 12.3 | 5.0 |
| 3. Promotion within the firm | 39.4 | 77.5 |
| 4. Government | 2.7 | 0.0 |
| 5. Another corporation | 15.7 | 15.0 |
| 6. Financial institution | 4.4 | 2.5 |
| 7. Others | 7.2 | 0 |
| Total | 100.0 | 100.0 |

19. What are the three most influential groups in the decision-making process before and after the restructuring? (Unit: Percentage)

| Value Label | Before restructuring | | | After restructuring | | |
|---|---|---|---|---|---|---|
| | First | Second | Third | First | Second | Third |
| 1.Shareholders | 17.6 | 6.1 | 16.1 | 23.5 | 9.1 | 18.8 |
| 2. CEO's | 73.5 | 21.2 | 0.0 | 61.8 | 24.2 | 3.1 |
| 3. Board of directors | 2.9 | 33.3 | 16.1 | 8.8 | 27.3 | 15.6 |
| 4. Middle managers | 0.0 | 27.3 | 45.2 | 0.0 | 15.2 | 34.4 |
| 5.Government | 0.0 | 3.0 | 3.2 | 2.9 | 3.0 | 6.3 |
| 6. Suppliers | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 7. Workers | 0.0 | 3.0 | 12.9 | 0.0 | 3.0 | 15.6 |
| 8.Customers | 5.9 | 6.1 | 6.5 | 2.9 | 18.2 | 3.1 |
| 9. Interest group | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 3.1 |
| 10. General public | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

20. What are the prevailing internal opinions within your firm about your firm's restructuring efforts? (Unit: Percentage)

| Value Label | 1999 |
|---|---|
| 1. Restructuring is necessary and is being adequately implemented | 67.6 |
| 2. Restructuring is necessary, but is not being adequately implemented | 26.5 |
| 3. Restructuring is unnecessary | 5.9 |
| Total | 100.0 |