Corporate Governance and Growth in the Korean Chaebols: A Microeconomic Foundation for the 1997 Crisis

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Abstract

From the perspective of Penrose's theory of growth of firms, this paper, first, interprets the rapid growth with diversification by the chaebols as exploitation of growth opportunities and available resources, given the rents associated with the domestic market protection and subsidized loans from the state-controlled banks. Second, taking chaebols as a variant of the controlling minority structure firm, the agency costs of the chaebols are analyzed in terms of unfair expropriation of other minority shareholders and debt-holders like the banks. For this analysis, the paper examines ownership and finance structures, dividend payments and stock prices, and bankruptcy cases in chaebols. The paper argues that the changes in the external economic conditions since the mid 1980s contributed to increasing costs and reduced the benefits of chaebol-type firms, as evidenced by their declining profitability and eventually the 1997 crisis.

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1. Introduction

The year of 1997 saw many Korean conglomerates or business groups fall into bankruptcy. One of them was Kia Automobiles, the second largest automobile company in Korea. Kia was very unique in that it is the only business group of the thirty largest Korean conglomerates that is not owned and controlled by a founder-family. Kia's bankruptcy refueled the hot debate in Korean society regarding the relative efficiency between the owner-managed firms, typical chaebols, and the professionally-managed firms under the dispersed ownership.[1] This paper considers the contrast between the "owner" and the "professional non-owning manager" in the debate as misleading in the sense that the controlling families in chaebols are not really "owning" majority shares; they own only about 10 percent of the shares in the group. In other words, the important distinction between the control by the majority and minority shareholders is not made in the discussion. The Korean chaebols are often wrongly said to be able to save the agency costs of the hired management whereas, in fact, they are subject to greater agency costs coming from the control of the firm by the minority shareholders.

This paper discusses this pressing issue of corporate governance and growth in the Korean firms. The focus is on the so-called chaebols, which are the family-controlled business groups that have been the backbone of the Korean economy. La Porta, de-Silanes, and Shleifer (1998) and Bebchuk, Kraakman, and Triantis (1999) find that the firms of controlling minority structures, like the cases of Korean chaebols,

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1. For earlier debate on chaebols, see Steers, Shin and Ungson (1989), Cho (1992) and Jeong and Yang (1992).

2. Controlled structure means that a large blockholder owns a majority or large plurality of a company's shares.

are widespread around the world. Not only in Korea but also in many other countries, the controlling minority structure (CMS) firms have recently come under close political and market scrutiny, especially after the 1997 crisis in Asia. In the controlling minority structure (CMS) firm, a shareholder exercises control while retaining only a small fraction of the equity claims on a company's cash flows. Such a radical separation of control and cash flow rights can occur in three principal ways: through dual-class share structure, stock pyramids, and cross-ownership ties. These three methods are exactly what is used by the Korean chaebols. The CMS structure resembles controlled structure insofar as it insulates controller from the market for corporate control, but it resembles dispersed ownership insofar as it places corporate control in the hands of an insider who holds a small fraction of equity (Bebchuk, Kraakman and Triantis 1999).[2] The focus of this paper is to examine the agency costs of the controlling families in the chaebols. This issue is interesting and also important because the CMS threatens to combine the incentive problems associated with both the controlling structure and the dispersed ownership in a single ownership structure, as well noted by Bebchuk, Kraakman and Triantis (1999). However, this important distinction of chaebol as a controlling minority structure from the controlling majority structure is missed in most literature on chaebols, including the more recent, post-crisis conference on chaebols, for instance Hyun (1999) and Nam, Kang, & Kim (1999).

The discussion in this paper will also help to understand the microeconomic foundation for the financial crisis in Korea in 1997. One perception held by many Koreans was that successive bankruptcies of chaebols and Kia Automobiles had damaged the creditworthiness of the Korean firms and economy. Both Koreans and foreigners thought that chaebols would never go bankrupt, but would always be backed by the Korean government and its concern with the socioeconomic impact of any failure within the big chaebols. But, the myth proved to be false, which triggered the termination of the roll-over of Korean-held debts in international banks. At the bottom of this crisis lies the chaebols' mismanagement of risks, namely the simple pursuit of heavily indebted growth. Such questions like what drove them to pursue such aggressive growth and why the banks and other stakeholders were not able to check such chaebol behavior, will be attempted to be answered here.

There is no doubt that Korean chaebols are a variant of the business groups in general, the importance of which has been increasingly recognized in the literature. In his discussion of this important social and economic phenomenon, Granovetter (1995) defines business groups as those collections of firms bound together in some formal and/or informal ways, characterized by an intermediate level of binding, namely neither bound merely by short term strategic alliances nor legally consolidated into a single entity. The Korean chaebols fit into this definition, and are also consistent with Strachan (1976)'s definition as there are strong personal and operational ties among the member or affiliate firms in a chaebol.[3] As noted in the literature, specific forms the business groups take in each country vary depending upon not only economic but also political and legal condition of the countries. In the case of Korea, protected domestic market, state-controlled banking sector, active industrial policy by the government, and so on,

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3 . This is how Strachan (1976) distinguish the typical American conglomerate from the business groups. In the case of the former, component companies are acquired and divested mainly on financial grounds and there are few operational or personal ties among the member firms, and they are inherently unstable. Recited from Granovetter (1995).

are the important influencing factors for the development of chaebols. Although the paper will naturally touch upon these issues, the focus will be on the impact of these factors on corporate governance and growth of the chaebols. In this paper the term, chaebol(s), is used to indicate the whole business group as a unit consisting of the member or affiliate companies. The terms, member firm, group-affiliate firm, or chaebol firm (company), are interchangeably used to refer to individual firm belonging to a business group, namely a chaebol. Actually, these affiliate firms are the legal persons, often listed in the stock markets and inter-locked by circular share-holdings, but a business group or chaebol itself is not a legal person in itself.

In the next section, the origins of the chaebols are discussed in terms of their source of growth potentials, the reasons for their diversification, and circular shareholding. Section 3, the main section, analyzes the agency cost structure of the Korean chaebols which is considered as a variant of controlling minority structures. Section 4 discusses the costs and benefits of the current chaebol form as an organizational choice, in terms of the costs of unchecked top management, effective internal discipline, influence costs, an end-game problem, and implementation power. It is presented that in terms of corporate governance Kia and chaebols are the same in that there is no effective monitoring from the outside. Sections 4 and 5 maintain that the net benefits of the chaebol system depend a lot on the external environment, and that the sudden deterioration of the environmental condition increased the costs and reduced the benefits of the chaebol system. Section 5 also examines the change in the external environment focusing on the change in the role of the government and the 1990 wave of liberalization and globalization. Finally, the paper concludes with a discussion on the future of the corporate governance system in Korea.

2. Evolutionary Shaping of the Chaebol System in Korea: Rent-seeking or Efficiency-seeking

Rapid growth with diversification is one of the most salient features of Korean chaebols. According to Penrose (1995), diversification is a way of utilizing its available "resources" in a more profitable way for the firm. This means that for diversification to happen two conditions need to be satisfied. The first is that an opportunity for profitable expansion of the firm exists, and the second is that the firm has extra resources to invest into a new business. Depending upon the situation, either of the two conditions may be binding. For example, when there is ample opportunity for profitable expansion, a more binding constraint is the firm's (internal) resources. This seemed to the case for the Korean chaebols.

During the high growth period of the 1960s and 1970s, the protected domestic markets and the preferential loans from the state-controlled banks opened up numerous profitable business opportunities(namely rents) for the Korean chaebols.[4] For example, during the heavy and chemical industry promotion drive by the government in the 1970s, the government directed banks and non-banking financial institutions to supply more than 50 % of total domestic credit as a heavily subsidized loan (Nam, Kang & Kim 1999; originally from Cho and Kim 1995). Given this, chaebols had to stretch their resources to the maximum to fully take advantage of the growth opportunity, and, at the

[4] . For the estimation of the amount of the rents, see Cho (1996). To see the nature and degree of oligopolistic market structure in Korea, see Chung (1993). The effective

same time, recruit more financial and managerial resources from the outside. The tendency to use this strategy resulted in very aggressive expansion often times without the backup of its internal resources and, the concentration of economic resources in the economy into the chaebols. Undeniably, it also laid the basis for a sudden break-down sometime in the future when such careless pursuit of growth was no longer profitable.

Among the stories about the growth of several chaebols, the diversification story of LG group, formerly Lucky-Gold Star, is well known, as it has been introduced in textbooks like Milgrom and Roberts (1992). One of the important implications of such a story about rapid growth with diversification is that with imports restricted and demand guaranteed, the only constraint for chaebols' growth was finding financial resources to invest into production facilities. Thus, real managerial skills were not as important as personal connections with government bureaucrats to bargain out preferential loans from the state-controlled banks. In this sense, the state granted two kinds of "rents" to chaebols, the rents of extra profits associated with market protection and entry control and the rents of preferential loans.

For those chaebols who were allowed the rents for growth, the two major concerns were to keep the controlling shares in the firms and to finance the growth at the same time. However, as the history of capitalism indicates, these two objectives are not easily reconciled, and thus history saw the natural separation of ownership and management, and the emergence of managerial capitalism (Berle and Means 1932). However, the Korean chaebols found a way to achieve both of the objectives, and that was through circular share-holdings. By forming a complex web of circular

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protection rates are presented in table 9 that comes later.

share-holdings, the founding owner-manager was able to control the whole enterprise group even with a very small share owned by his own family. Whenever the chaebols started a new business, they did so by establishing a new firm as a new member firm in the chaebol group. Capital for the new firms was financed in very little part by the owner family's funds and came mostly from the other member firms and the banks. Relatively few firms openly raised funds in the stock market until the 1990s.[5] In other words, establishing a new firm was a much easier and cheaper way to finance the new start than forming a new division inside the old firms using its funds alone.

Table 1 shows the share composition in the chaebol firms. On average, the owner and relatives own only about 10 percent of the chaebol group’s stock in the top 30 business groups. More than 30 percent of the stocks are owned by the other member firms in the same chaebol group. However, these stocks are mutual exchanges among themselves. For example, firm A in a chaebol group owns a share of firm B worth 100 million Won, firm B owns a share of firm C worth 100 million Won, and finally firm C owns a share of firm A worth 100 million Won. This 100 million Won does not represent a real asset and it is a paper asset existing only in the accounting system. However, this paper asset contributes in keeping the controlling share of the member firms in the owner families. In other words, as Table 1 shows the insider's share ratios (the sum of the shares owned by the owner-relatives and the member firms) are as high as 44 percent in the 30 largest chaebols in Korea. This way, the owner-families were able to keep the control over a large number of the member firms with only a less than

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[5] . Of course, this also had to do with the primitive nature of the Korean stock market itself.

proportional amount of real financial capital. However, the adjusted insider share ratio amounts to only 15.6 percent if we exclude the circular holdings of paper assets.

Table 2 shows how Korean chaebols financed the acquisition and growth of their assets. In 1986, about 32 percent of the newly increased assets were internally financed. This ratio of internal financing continued to decrease to be only 12 percent in 1996. As a consequence, as table 3 shows, the share of the owner and relatives decreased from 16 percent in 1987 to 10.3 percent in 1996.

If there were rents in terms of domestic market protection and preferential loans, it would be natural for chaebols to take advantage of these rents in pursuing growth. However, existence of rents does not seem enough to explain the expansion tendency of chaebols, especially given the fact that there was substantial degree of market liberalization and reduction of subsidized loans since the 1980s. As a matter of fact, the chaebols are perceived to acquire, or enter into, a business which is often not justifiable in terms of rate of return of investment. Theoretical models presented in Bebchuk, Kraakman and Triantis (1999) give us a persuasive clue to this question. The models explain why inefficient projects are chosen and unprofitable expansion are pursued under the CMS. The basic idea of the model is as follows.

Suppose that there are projects which can produce a value of V that includes cash flow (S) available to all shareholders and private benefits of control (B). Then, between the two alternative projects that generate different cash flow and private benefit, the model shows that the probability that the project generating a bigger private benefit is chosen increase at a sharply increasing rate as α decreases (α is cash flow rights of the controlling minority shareholder). For example, with a value of α as 10 %, which is roughly the average value in the top 30 chaebols, a controller will reject the efficient project unless the value gap between the two projects is more than 27%.

Another model in (Bebchuk, Kraakman and Triantis 1999) shows that given any distribution of opportunities to expand and contract, the likelihood that a CMS firm will make an inefficient decision--and thus the expected agency cost--grows larger as the controller's equity stake α becomes smaller. A controller will prefer to expand (or not to contract) a firm if $\alpha(V-B)+B>\alpha P$, where P is the buying or selling prices of the asset. For example, with a value of α as 10%, the controller will refuse to sell the asset unless the firm receives a price 45% higher than the real value of the asset to the firm. Equivalently, the controller will acquire the asset unless the price is more than 45% higher than its real value to the firm. In this model, too, the deciding factor is the magnitude of private benefits accruing to the controller when he keeps or acquires the asset, and private benefits tend to come from self-dealing or appropriation opportunities. In the Korean context, typical private benefits also took the form of arbitrary and preferential borrowing from the firms and many kinds of outright cash payments to the controlling shareholders. These models suggests that the unique agency costs structure of the CMS firm pushes chaebols to pursue more growth than otherwise.

An analogy has often been made between the American style M-form (multidivisional) firms and Korean chaebols. Subordinate member firms in the Korean chaebols enjoy little autonomy from the group headquarters (or Planning and Coordination Office, known as gi-jo-sil) and so are more or less equivalent to divisions in the M-form firms. In this respect, chaebol firms are also different from the business groups in Japan, which enjoy more autonomy and command more independence from other firms in the same intermarket (horizontal) business groups or the group itself (Gerlach 1989) . Table 4 shows the degree of synchronization of stock price change among member firms in the same business group. It is as high as 77.6 percent for the chaebols firms belonging to the 6th to 10th largest chaebols. This means that there is a 78 percent probability that the stock prices of these firms belonging to the same group move together in the same directions. Such synchronization tendency is shown to be weaker for the firms belonging to the largest 5 chaebols, with a degree of 37.6 percent. The synchronization tendency reflects the degree to which the member firms are linked together in terms of cross-subsidy by internal transactions and cross debt-guarantee, and can be a measure of independence of the member firms.

Although each chaebol looks similar to a M-form firm in terms of the autonomy of the member firms, the origins are different. It is familiar that, the American M-form firms was an organization innovation from the former U-form firms, which have been explained from a transaction cost perspective (Williamson 1975). In contrast, the Korean chaebols started from U-form firms and first evolved to mixed type firms, something similar to what are known as X-form firms (Williamson 1975: 154) because they establish more and more new member firms with external financing. As Williamson observes, X-form firms emerge when U-form firms expand into new business areas as they do not feel the need to invest cash surplus back into the existing field once established as an oligopolistic power in the existing field. In fact, many Korean chaebol groups have core companies, which were the first mother companies[6], and the mother companies have generated many spin-off firms. The spin-offs are largely

[6] . This core company serves the role of holding together the companies in the group. In practice, they are not pure holding companies but are called "business holding companies" as each has its own active business and at the same time holds shares of many of the other member companies in the groups.

financed by loans from the banks and partly the mother company and the owner-families. The reason that the mother company does not want to keep new business as a division within a mother company but to separate it as a new firm is that, being a new separate firm, it can more easily get loans from the banks through debt guarantees from the mother company. Furthermore, the owner-family and the mother company, together, do not have to own the 100 percent of the interest over this new business as it can also raise capital by issuing and selling shares to the public.[7]

In sum, the origins of the Korean chaebols as a variant of the M-form organization can be better explained from an evolutionary perspective, like that of Penrose (1995), than from a transaction cost or market failure perspective, although the latter can give some *ex-post* rationalization of the current behavior of chaebol groups.[8] For example, Goto (1982) argued that the firms may reduce the transaction costs, and may avoid scale diseconomies or control loss by forming a business group, and Leff (1978) understood group pattern of industrial organization as a microeconomic response to well-known conditions of market failure in the less-developed countries, especially capital and intermediate product markets. But, as Granovetter (1995) criticizes these functionalist accounts of business groups, there is no guarantee that the correct level of

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7 . It is observed that the reason that the American firms want to maintain 100 percent share ownership over newly established subsidiaries even when it is possible to finance the new business in public offerings is that they want to avoid the conflicts or interference from the minority shareholders who are very apt to exercise their rights as shareholders.

8. A more rigorous empirical study on chaebols from a transaction cost economics perspective is Chang and Choi (1988). For the relationship between diversification and profitability, see Lee and Han (1997).

coordination will be supplied by the headquarters of the groups. But, where this occur we may expect to see better economic outcomes, and the Korean chaebols might be the case to a certain extent, during the specific period in particular but not in general, which will be discussed later.

3. Agency Costs in the Korean Chaebols as a CMS firm.

In the standard theory of the firm, typical agency costs have to do with the hired management under the dispersed share ownership (Jenson and Meckling 1976; Fama 1980). While such an agency structure is typical of American firms, in Japanese firms the main banks play an important role as the final monitor over management (Aoki 1990; 1987). Agency cost structure in the Korean firms does not fit either of the two cases mentioned earlier. As discussed in the Section 2, the owner and relatives own only 10 percent of the shares but control 100 percent of the firm. This means that the agency problem in the Korean firms is the bulk of power disproportionately divided in favor of the managers with a 10 percent of the shares vs. the rest of the shareholders with 90 percent of the shares. In a sense, the title "owner" (which is often used in Korea) of the chaebol is not an appropriate one as they hold only 10 percent of the share. It is also not fully accurate to identify them as the "principal" in the principal-agent structure. At the same time, the owner families are also different from the professional management in the diffusely owned firm as they actually control the firm with their own stocks combined with circular shareholding, and, more importantly, they have long time horizons. In this light the structure of the Korean chaebols can be considered as a variant of the CMS (controlling minority structures) as analyzed in Bebchuk, Kraakman, and Triantis (1999). There are two kinds of major agency costs in the Korean style CMS. The first is the agency costs of expropriating the rights of other minor shareholders and, the second is the agency costs of ignoring the rights of debt-holders. The next discussion deals deal with these types of owner-manager agency costs.

The first agency cost: 90 percent of Shareholders' rights ignored:

First, in regards to the rights of shareholders, the governance structure in the Korean chaebols give super-protection for the controlling incumbent management, while the rights of minority shareholders are minimal. It is well known that the price gap between the common stocks and preferred stocks, which is a measure of the management premium, is very large in Korean firms. In an international comparison, the price of common stocks is often twice as high as that of preferred stocks in Korea. Another measure of shareholder rights should be the amount of dividends. Table 5 shows the dividends to net income (profits) ratio in several countries. Dividend rates relative to profits are also very low in the Korean chaebols, only 14 to 20 percent or approximately 20 percent, compared to about 40 percent in the US and Japan. One of the reasons for such a low dividend ratio is that the owner-managers want to avoid the heavy income taxes imposed on their dividend incomes. Instead, they want to be compensated in the form of arbitrary and preferential borrowings from the firms and many kinds of arbitrary cash payments to the owner-shareholders. In practice, the distinction between the official money of the firm and private money of the owner is often blurred in Korea, as has been revealed in the several cases of bankrupt chaebols in

1997.

Secondly, the return to dividends measured by the ratio of dividends to the price per share (about 1.5 percent) is very low compared to interest rates (9 to 10 percent) in Korea. In the US, the ratio of dividends to price per share reaches up to one half of the interest rates. This situation in Korea tends to make stock investment less attractive than bank savings, which explains the decreasing stock capitalization ratio and decreasing stock investor population in the 1990s. Table 6 shows that the stock investor population decreased from 2.4 million in 1990 to 1.46 million in 1996.

In the American firms, it is said that dividend ratio is proportional to profit performance, meaning the more profits, the more dividends. According to Okumura (1984), there is a reverse relationship between the profit performance and dividend payments as the dividends are supposed to be more or less fixed regardless of the firm’s performance. In other words, when profit rates are high, a lower dividends to profit ratio is enough to guarantee a fixed amount of dividends to shareholders. This tendency reflects the fact that in Japan shares are not owned for the purpose of capital gains or dividends but for the control or connections that come with share-owning. With the proportion of individual shareholder (about 30 percent) falling between that in the US (about 40 percent) and that in Japan (about 20 percent), there is a somewhat weak relationship in the Korean firms between profit performance and dividend payments as dividend payments are subject to the owner-manager's discretion. Table 7 shows dividend figures of the 30 largest chaebols in Korea. On average, the dividends to net income ratio was 18.32 percent in 1995. The correlation coefficient between dividends propensity (dividends to net income) and capital profitability (net income to capital stock) is as low as 0.36 in 1995.

Furthermore, the institutional investors in Korea, including the pension funds, investment and trust funds, are forfeited their voting rights as shareholders, as a result of the over-protection of the incumbent manager-owners. Even for the individual shareholders, their rights as shareholders are almost nil in terms of the right to call for the shareholders meeting, to attain access to the accounting books of the firms, to raise lawsuits against the management, and so on.[9] This is in quite contrast to the instance of the US where the individual shareholders account for the largest shares in the average listed companies and enjoy substantial rights as shareholders.

Because the voices from the minority shareholders are very weak, the management with the controlling shares is not subject to constructive checks from the minority shareholders. While it has the benefit of promoting managerial initiative, it has the intrinsic cost of managerial dictatorship as well as weak incentive to invest in Korean stocks. Weak investment motivation in general tends to translate into higher capital costs, however, that was not the case with the Korean chaebols. Money borrowed from the banks was very cheap in many respects, and thus they did not feel much need to bother to issue shares to attract new money. I will turn to this issue in the following section.

The Second Agency Cost: Debt-holders Rights Ignored

In Korean firms, another serious problem was the agency cost of the owner-manager in its relation to the lenders. In comparison to American firms, firms in

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9 . Actually there are in place various devices to protect minority shareholders but they are all nominal and never utilized in practice (Nam, Kang & Kim 1999).

Korea, Japan, and Germany tend to rely more on borrowing from the banks. In Japan, the banks not only lend to the firms but also own the shares, and the relationship between the banks and the firms is characterized by the "main banks" system, where the main bank of each firm plays the role of its monitor.[10] In German firms, the banks are able to participate actively, based not only on their own share holdings but also on the delegated voting rights they have acting as monitor and advisor to the firms (Berglof 1989; Cox 1986). The case of the Korean chaebol firms fits none of these representations.

What was the role of the Korean banks? Their role during the high growth period was to provide the so-called "money for growth" whenever the firms needed it and when the government asked or commanded the banks to lend to the firms. The banks were nationalized right after former President Park Jeong Hee took power by military force in the early 1960s, and were under *de facto* control by the government, specifically the Ministry of the Finance (MOF), even after the nominal privatization since the 1980s. Thus, the effective lending criteria of the banks were the signals or orders from the government. That was the only way for bankers to keep their positions. The banks were also very cooperative with the MOF because many high-level positions tend to be filled by the former staff of the MOF. Consequently, the basic behavioral pattern of the banks was passive and incentives did not exist for them to keep watch of how money was spent in the firms. The primary lending criteria, as applied by the government, was the promotion of specific export-oriented industries while the profitability of the project itself was only a secondary matter. For the banks, there was

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[10]. For a recent assessment of the main bank system, see Weinstein and Yafeh (1998).

no incentive to monitor the chaebols since they have all their loans backed by collateral and/or cross-guarantees by the member firms. As a result, the banks did not have to examine the creditworthiness of the borrowing firms. Furthermore, the Korean capital markets were always in sellers' market conditions and closed from the threat of foreign competition. So the banks' level of efficiency was quite low.

The weak monitoring by the banks can also be partly explained by the regulations on the banks' equity participation in non-financial firms. Under the 10%, or more recently 15%, ceiling on their equity share, the banks' main motivation to hold shares in non-financial firms was not management control or influence but capital gains (Nam, Kang & Kim 1999).[11] Furthermore, the banks' role as a shareholder was severely limited due to regulations mandating "shadow voting," an obligation to vote with the management side. Despite the fact that the banks did not enjoy any rights as debt-holders or equity holders and had no say over the management, they took most of the financial burden when the firms went into a bad situation. The financial distress of the firms often led to debt reduction, roll-over, or even more lending from the banks, leading to a typical soft budget constraint (Kornai 1980) or moral hazard situation similar to the firms in the socialist planned economies. As a matter of fact, the Korean government was heavily involved in massive bailouts on numerous occasions, including the "emergency debt freeze" in 1972, restructuring of major heavy and chemical industries in the early 1980s, and "industrial rationalization measures" in overseas

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[11]. Regarding individuals or chaebols' ownership of shares of the banks, there was initially a 8 percent ceiling in 1982 when the banks are privatized, and later the restriction was further strengthened as the ceiling was lowered to 4 % in 1994 as financial liberalization made progress.

construction and shipping industries during the mid-1980s (Nam, Kang & Kim 1999). The government bailouts exacerbated the already weak market discipline, and 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 (ibid.).

The existing moral hazard situation under the soft budget constraint led to excessive risk taking by the owner-management. As Milgrom and Roberts (1992) observe, it was an expected event as the costs of any failure were shared or transferred to the lenders, whereas benefits of any success are monopolized by the incumbent management. This situation followed something like a "debt-growth" spiral, in which more and more debts were resorted to in order to finance more growth (see table 2). However, it was clear that the chaebols did not practice any risk management or worry about their loans since they did not believe that the banks would ask them to pay back the loans suddenly and assumed that the banks were always ready to roll over the debts. As a matter of fact, chaebol firms borrowed money with cross-guarantee among the member firms, so that default by one firm could lead to a chain-reaction effect to other firms in the same group since their total cross-guarantee is way beyond their pay-back capability.

4. Balancing the costs and the benefits of the Owner-managed firm and professionally-managed firm.

Kia's bankruptcy in July 1997 refueled the hot debate in Korean society regarding the relative efficiency between the owner-managed firm (OMF), typical of chaebols, and the professionally-managed-firm (PMF) with the separation of ownership and management. Many proponents of the chaebols criticized that the Kia case is the most clear-cut evidence of the inefficiency of professional management who are subject to the agency costs of the hired management. What went wrong in Kia? My view is that in the most important dimension of corporate governance, Kia and chaebols are the same in that there is no effective monitoring from the outside. Both types of firms in Korea are subject to neither discipline from the stock market as in the US nor the checks and balances from the main banks as in Japan. The board of directors in the Korean firms have no effective voice regarding the management and play a very nominal role.

The consequence of unchecked owner-management was very authoritarian decision-making where no effective and diverse voices were considered in the owner's decision making. In general, it is widely believed that in chaebols few can speak against the will of the owners without risking one's own job. Thus, the costs of such one-man dominated management is substantial in that strategic decision making can go wrong due to the misjudgment of the owner. It is reported that in many cases of Korean chaebol bankruptcies, one of the most important causes for the decline of the firms has to do with the wrong strategic decision made by the owner, especially by the second generation owner-manager who inherited the company from his father.

Table 8 shows the list of the recently bankrupted companies and whether the chaebols had a succession from a founder to his descendants before the bankruptcy. It is shown that out of 24 cases, 14 cases had a succession several years before the bankruptcy. The typical behavior and motivation of the second generation owner-management is observed to include a very aggressive mind and a desire to prove that he is as good as his father, and to prove that he can achieve something new and different. Such a mentality leads to careless expansion into new business areas, which often puts the whole group into jeopardy.

If the higher possibility of failure in strategic decision making is the point of weakness of the owner-managed firms, weaker internal discipline may be the fault of the professionally-managed firms, like Kia. It is often observed that the CEO of Kia does not have as much power as the owner-CEO in chaebols. Thus, internal discipline of the workers is weak in Kia; the labor union in Kia is regarded as one of the most radical in Korea. Some argued that profiteering by staff in their transactions with sub-contracting vendor firms were very serious corruption problems in Kia compared to other firms.

The chaebol firms may exercise more strict discipline within the firms, but they are subject to the costs of influence activities and the end-game problem. According to Milgrom & Roberts (1992, p. 192-3), influence activities arise in organizations when organization decisions affect the distribution of wealth or other benefits among members or constituent groups of the organization and in pursuit of their selfish interests, the affected individual or groups attempt to influence the decisions to their benefit. These influence activities incur influence costs. The magnitude of the influence costs depends on the existence of central authority and the kinds of procedure that govern decision making. The paramount central authority of the owner-manager in the chaebol makes the organization prone to influence activities. It has been said that the desk of the owner-manager in the chaebols are piled up with private letters and reports informing them of the misbehavior or wrong doing of the staff. The time and effort spent on writing these reports are a part of the influence costs. Although the beneficial side of the influence activities are increased monitoring and information collection in the firm, it is somewhat doubtful how reliable the reported information actually is, and the organization's reliance on such informal activities to enhance monitoring and information gathering is not harmless. To the extent that influence activities are rampant in the organization, the organization can be said to be in need of decentralization.

The end-game problem refers to the situation that agents face when they are tempted to cheat toward the end of a repeated finite game. If they know they are approaching the end of the game (losing their job), and the returns to maintaining a reputation are seen as small, the desire to uphold their dignity may not be enough to prevent trust from being violated (Milgrom and Roberts 1992, p. 266). As it is well known, in the repeated game, the agents' incentives to cheat are checked in part by the effects it will make on one's reputation. However, if it is a repeated but finite game, the gain from cheating might surpass the value of the reputation toward the end of the game. A similar situation might develop among the professional but owner-picked managers in the Korean chaebols. In the chaebol firms, it is very typical that job security decreases quickly as you ascend the corporate ladder. The higher you go, the sooner you are kicked out of the firm. To some extent, this phenomenon is general to firms in any country. However, in the case of chaebols, with the owner-manager at the top, there is no real possibility for the professional manager to ever become the most powerful person in the firm. Furthermore, when there is a succession in the firm from father to son of the owner family, the old senior and experienced groups are shortly kicked out together. This situation means that the senior managers in the chaebol might be more tempted to cheat or to plan ahead before his possible discharge from the firm. A partial solution for the end-game problem is to introduce a formal incentive scheme linking CEO pay to stock market performance. However, in Korean chaebols such CEO schemes are rarely adopted and the stock options are just being introduced and mostly in venture companies.

Lastly, another comparison can be made between the OMF and PMF in terms of implementation power. My argument is that the OMF tend to have a greater implementation power vis-a-vis the PMF. With absolute authority within the firm, the owner-manager can override any countervailing opinions and push through the execution of target projects. Such power is important, especially when the government guided the economy by giving private firms clear signals on the list of the industries or projects that the government planned to promote. As a matter of fact, the chaebols tended to have strongly influenced the industrial policies of the government. However, in the PMF, with less absolute authority, the top management takes into consideration more diverse opinions within the firm and tends to be slow in pushing things ahead even after a consensus is reached, probably after long intervals. I think this was the scenario in the case of Kia. The professional management of Kia is generally believed to have relatively weak bargaining power in their dealings with the labor union which was mentioned earlier as being one of the most radical in Korea. The authority within the firms is not comparable to that of the owner-manager led firms. However, it should be noted that the importance of the implementation power of the owner-manager firms became smaller as the government stopped the interventionist industrial policy, such as selective protection of target industries or firms. In this situation, the uncertainty of the owner-management grew larger.

Given the complicated structure of the weaknesses and strengths of the chaebol system, it is not a simple task to figure out the net benefits of the chaebol system. However, what is certain is that the net benefits of the chaebol system depend upon the external environment within which chaebols operate. In the next section, this point will be discussed as the background for the 1997 crisis.

5. The Unchanged Chaebols under the Changed Environment: The Seed for Breakdown

The year of 1997 saw the collapse of one after another chaebol in Korea and finally of the economy itself, which led to Korea's situation of having to beg for the IMF emergency loan. What went wrong with the chaebols in Korea? The answer to this question dates back to the origin of the growth of the chaebols. As discussed earlier, the environment nurturing the growth of the chaebols was an economy which abounded with artificial rents and protection. The fundamental change in the nature of the external economic environment lies at the bottom of the crisis of the chaebols and the economy itself.

We should note the two important changes in the external environment. First, the government has gradually stopped the explicit promotion of, or giving favor to, specific industries and firms. This does not mean that the government stopped intervention in the private sector, but it means that many kinds of once legal promotional policies of the government have disappeared. These policies included the so-called "policy loans" which were given to the designated firms in the target industries at interest rates much lower than market rates, special export credits given at lower interest rates, and arbitrary tax exemptions to the target industries. It was actually during the 1980s, that the government itself declared it was switching from the policies of selective intervention to those of functional intervention. The change meant that the government intended to recover the normal functions of the market mechanism from the past distortions. Also, it came to be that to be recognized as an elite economist of the economic ministries in Korea, and especially to be welcomed by the chaebol-led business community, one had to wear the brand of being a "man of market principles." Although uncertainty remained to the degree they really devoted to, and understood the concept of, market principles, they all seemed to agree that they could no longer give outright favors to specific industries or certain firms only.

In general, the change in the government attitude and its actions toward the private sector contributed to the lowering of the rents enjoyed by the chaebols. However, many bureaucrats started to claim a part of rents or profits of the private firms for illicit private gains, abusing their power and discretionary authority in giving business licenses and permission, inspection, tax imposition and collections, and so on. They are the ones who opposed the general drive from the top leadership for deregulation, in fear that their share of the illegal pie would disappear. Roughly speaking, the government gave up promotional industrial policies but bureaucrats have continued to interfere with the private sector for private gains.

Second, we should note the rising wave of globalization and the WTO spirit of free trade in the 1990s. The 1990s is the decade that the Korean economy saw the fulfillment of most of its liberalization programs, including both trade and capital markets. Such liberalization measures caught further momentum following the Korean entry into the OECD. Table 9 shows the downward trend of effective protection rates over the 1963-1990 period. Toward the end of the 1980s, the effective protection rates for manufacturing goods were reduced to less than 10 percent or even fell to negative levels. Section B in the same table shows that custom rates for the imported goods decreased from more than 20 percent in the early 1980s to about 5 percent in the mid 1990s.

With the domestic market opened and liberalized, the Korean firms including chaebols have faced the increasing competition from foreign firms. In the world markets, on one hand, Korean comparative advantages as a low wage country have disappeared with the rise of ASEAN and Chinese exporters, and, on the other hand, Korean products cannot afford to compete with the products from an advanced country, like Japan, in terms of quality and product differentiation. In general, this trend of globalization and liberalization has contributed to the lowering of the rents and decrease in profit rates enjoyed by the Korean chaebols.

Table 10 and figure 1 show the long term trend of the profit rates (ROE: net income to stock holders' equity) over the 1980 to 1996 period. The profit rates in tables 10 are adjusted measures, which are different from the profit rates measured in terms of the book values; they are estimated using the market values of the assets of the firms.[12] In general, it shows the decreasing trend over the period concerned. For the large-sized firms which include most of the chaebol firms, the profit rates have changed from 0.3 % during the 1980-84 period and 13.3 % during the 1985-89 period to 0.2 % during the 1990-96 period. It is important to note that the profit rates for the large sized chaebol

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[12] . The estimation is done in Yoon (1998). According to this, the adjusted rates tend to be lower than the original rates during the 1990s, whereas they were higher during the 1980s. This difference originates from the fact that during the 1990s prices of the land and other assets declined substantially.

firms tend to be consistently lower than the small or medium-sized firms since the mid 1980s when the trend of profitability passed the peak.

The rising wage costs are an additional factor which contributed to the eroding profitability of the Korean firms. As McKinsey (1998) observed, the return on investment (ROI) was lower than interest rates. It should be taken into consideration that although Korean firms faced relatively high capital costs (interest rates), their ROI's themselves were lower than those of other countries. It is in this sense that McKinsely (1998) calls what is happening in the Korean industry "value destruction" rather than value creation.

Table 11 measures the short term change of the profit rates for the 30 and 10 largest chaebols during the 1994-96 period. It is shown that over the period all the measures of profitability have declined by a substantial margin for the 30 largest business groups although the base year of 1994 is a special year at a peak of a small business cycle. The trend is more clear-cut for the profitability measured using the ordinary income rather than operating income. The difference between these two is the financial expenses including interest paid. The ordinary income to stockholders' equity rates declined from 8.46 percent in 1994 to a mere 0.75 percent in 1996 for the 10 largest chaebols.

What do these changes mean for the balance sheet of the costs and benefits of the chaebol-type firms? It is clear that the benefit side has lost. With lower benefits, balancing the costs and benefits of the chaebol have become difficult, and now the costs side has started to loom largely. In other words, the costs of over-diversification suddenly are felt much more strongly than before. As mentioned before, diversification was a somewhat rational response of the chaebols to the environment. But, now that the environment has changed, and there has been an increase in competition, it is not easy to make money in many industries. Unfortunately, the chaebols did not command enough flexibility to meet the new challenge, or were too big to change quickly. The source of the inflexibility has to do with both the seemingly M-form like over-diversified organization with few exit possibilities and the unchanged mind of the top management.

The quality of the top management might have actually worsened as the founder-managers were succeeded by their sons, whom did not have verified managerial talents. The challenge to the inherited management was in general more demanding as the size of the firms had grown bigger and the entry into the global business environment was more complicated as well. In other words, the burden on the top management had become much heavier and the need for decentralization was evident. Decentralization was necessary as the member firms in the Korean chaebols enjoyed much less autonomy than the division in the M-form and because the necessary separation of the strategic and operational decision-making processes was not made. In addition, the benefits from the strong implementation power of the owner-managed firm had become less important as the government stopped explicit industrial policy.

The above discussion indicates that the both external environment and internal conditions in the 1990s are quite different from those in the 1970s and the 1980s. If the tendency of declining profitability was real, then we have to ask why the chaebols did not stop their relentless pursuit of simple expansion. For example, even in the 1990s the average number of affiliate firms of the top 5 chaebols has continued to increase, and, more importantly, their debt/equity ratio have increased even to 500 percent level (for top 30 chaebol) just before the crisis in 1997 (Hyun 1999). It was a very rapid increase since it was around 400 percent in 1996, and around 330 percent during the 1991-92 period (Nam, Kang & Kim 1999). Intrinsic rigidity or inflexibility running against any changes should not be a sufficient answer. As discussed in section two, with the help of theoretical models presented in Bebchuk, Kraakman and Triantis (1999), the agency costs structure implied by the controlling minority structure has led to the situation that inefficient projects are chosen and unprofitable expansion are pursued. In other words, given the private benefits associated with the expansion, the controlling minority shareholder has tended to acquire or enter into the business, which is not justifiable in terms of its rate of return.

6. Searching for the New Corporate Governance in Korea

Nowadays the voice for change is loud in every corner of Korean society, and the corporate governance system is not an exception; it is at the center of attention (Hyun 1999). The basic directions for change can also be sought in terms of the origins of the chaebols. As mentioned above, the current chaebol structure is shaped by the artificial distortion of the natural tendency of the separation of ownership and control with the firm growth and by the owner's desire to maintain his position as both the investor (owner) and the manager. Then, the basic direction for change should be a recovery of the natural tendency of separation of ownership and management, dividing the double roles of the owner-manager. This means that two main types of transitional organizational forms can exist.

The first is the real separation of the ownership and control, or the separation of the investor and the manager. The former owner-manager can only be either owner or the investor interested solely in the return of his portfolio investment. The former member firms in chaebols would become more autonomous units as the current owner-mangers limit their role as investors or as non-managing shareholders. The owner-family might want to create a foundation but would not interfere with the management. The Hewlett-Packard Corporation in the US is an example of the owner's retreat into the back seat after he established a foundation. Among the Korean firms, Samsung's highly centralized ownership and control pattern might make it suitable for this type of arrangement.

The second is the dissolution of the collective group organization, but the owner-managers would be allowed to take control of the management over a few member firms. In this case, the owner-manager could concentrate his limited capability or interests to one or two of the member companies and let the others become independent or be sold out. The LG, Ssangyong, Daesang (formely Miwon), and Haitai, who are already in the process of reorganization, seem to be taking this choice of change. Of course, a natural dissolution of the group could happen if the founder gives the member firms to his children and allows each inherited firm to become independent. Hyundai group is more likely to take this path, after, or maybe even before, the paramount founder, Chung Joo Yong, dies.

It might take longer time than we expect for these two forms of organizational transition to take place. In the meantime, the following changes in the corporate governance would be necessary or expected. First of all, there will be the strengthening of the rights of the minority shareholders, together with the full recovery of the voting rights of the shares held by the institutional shareholders. Second the debt-holder (banks) will play an increasing role as a monitor for the firms. Third, the inclusion of the outside or independent directors in the board and an increase in the board’s power are expected. These three changes are logically derived from the preceding analysis, and since the onset of the crisis have already begun to be implemented in Korea.

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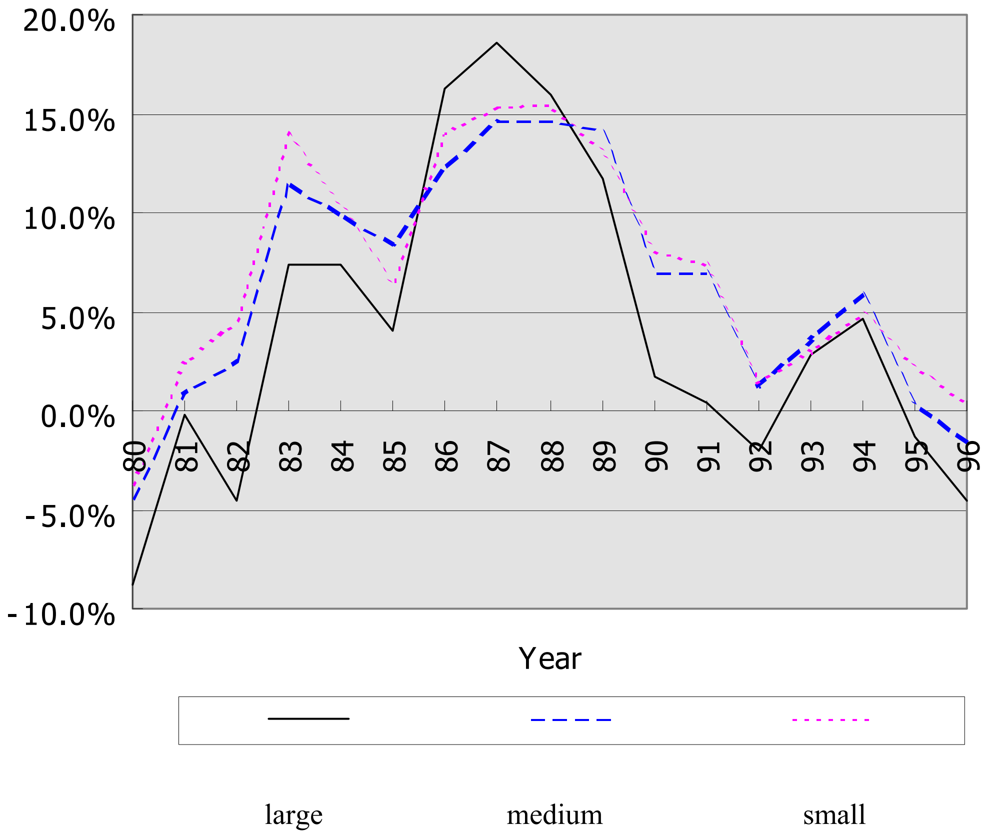
Figure 1: Profit(Net Income) to Equity Ratio by Size of the Firms(%)



Source: Based on table 10.

Table 1:
Ownership Structure in Chaebols

(As of April 1st, 1996)

Chaebols	No. of member firms	No. of business sectors	% of shares owned by		Insider's Shares	Adjusted Shares	Equity to Asset Ratio	Degree of Openness %	
			Owners & Relatives (A)	Member Firms & Self-owned (B)	(A + B)	A/(1-B)		By Capital Stock	By No. of Firms
Hyundai	46	38	15.39	46.02	61.4	28.51	20.99	44.31	34.78
Sumsung	55	30	2.97	46.04	49.01	5.5	32.7	55.22	25.45
LG	48	29	5.97	33.91	39.88	9.03	24.2	60.21	22.92
Daewoo	25	27	6.35	35.35	41.69	9.82	22.91	86.19	36
SunKyong	32	24	16.1	32.54	48.64	23.87	23.27	56.86	15.63
Average:									
1st-5th	41.2	29.6	8.2	39.65	47.85	13.58	25.14	62.34	26.69
5th-10th	24.4	24.6	9.53	21.63	31.16	12.16	20.94	64.14	30.32
11th-20th	19	16.8	9.81	29.83	49.64	13.98	17.21	54.95	23.15
21st-30th	15.1	12.4	10.17	32.69	42.86	15.1	16.47	66.17	23.17
1st-30th	22.3	18.8	10.32	33.82	44.14	15.59	22.34	62.08	25.56

Note: Equity to asset ratio refers to non-financial institutions only. Degree of openness measures the proportion of the member firms that are listed in stock markets either by the number of them or in terms of values of the capital.

Source: Korea Fair Trade Commission

Table 2:
Asset Growth and Financing in the Korea Firms

(Unit: billion Won)

	86	87	88	89	91	92	93	94	95	96
Values of Asset Increases (A)	8,422	15,934	13,827	22,152	37,626	21,063	33,293	55,234	48,050	48,877
Cash Flow (B)	2,656	3,234	4,043	3,664	4,798	3,974	5,309	9,152	14,121	5,631
Rate of Internal Financing	0.32	0.20	0.29	0.17	0.13	0.19	0.16	0.17	0.29	0.12

Note:
1. Values of Asset increase is defined as asset value of the present year minus asset value of the previous year.
2. Cash flow is the sum of the net income, depreciation allowance, and other exempted taxes.

Source:Bank of Korea, Performance Analysis of the Firms in Korea (in Korea), various years.

Table 3: Trend of Ownership Structures in Chaebols (1987-1996)

(Unit: %)

Year	Owners & Relatives (A)	Member Firms & Self-owned (B)	Insider's shares (A+B)	Adjusted Shares of Owners A/(1-B)
1987	15.8	40.4	56.2	26.5
1989	14.9	31.3	46.2	21.4
1991	13.9	33	46.9	20.7
1993	10.2	33.2	43.4	15.3
1995	10.5	32.8	43.3	15.6
1996	10.3	33.8	44.1	15.6

Note: Here the Chaebols include those of which the value of assets are over 400 billion Won during the 1987-91 period. Since 1993 the 30 largest conglomerates are designated in terms of their asset values.

Source: Fair Trade Commission

Table 4: The Degree of Stock Price Synchronization in 1997

The 5 Largest Chaebols	37.6%
The 6th to 10th Largest Chaebols	77.6 %
The 11th to 30th Largest Chaebols	75.6 %

Source: The Korea Stock Exchange (reported in Maeil Business News, 98/6/24)

Table 5: International Comparison of Share Dividends

	Dividends to Price per Share		Average Official Interest Rate (95')	Dividends to Net Income	
	1995	(1990-96)		(93-95)	
Korea	1.30%	1.75%	9-10%	14-20%	21.9%(95')
U.S.A.	2.91%	2.48%	6%	79.6%(93')	39.9%(94')
U.K.	4.49%	4.43%	8%		
Japan	0.85%			30-50%	

Source: Korea Stock Exchanges

Table 6: Distribution of Stock Ownership in Korea

(% of No. of Shares)

	1990	1995	1996
Individual		36.40%	34.30%
Institutional investors		32%	31%
Foreigners		10.10%	11.60%
Corporations		13.40%	15.50%
Population with more than 10 shares	2,400,000	1,548,392	1,464,731

Source: Korea Stock Exchange (reported in Hankyeryo 97/3/26)

Table 7: Dividends Payments of the 30 Largest Chaebols in 1995

Chaebols	No.of Listed Co.	Dividends Per Share (Won)	Dividends (million Won)	Dividends to Net Income Ratio (A)	Ranks by (A)	Capital Stock	Net Income to Capital Stock
Hyundai	18	290	89,073	24.88	18	3,087,156	2.89%
Samsung	14	379	151,022	5.41	24	2,497,617	4.89%
LG	12	445	181,527	57.27	2	2,613,958	5.88%
Daewoo	9	141	122,716	39.97	9	3,616,203	3.98%
SK	4	300	43,604	34.65	12	952,356	1.41%
Ssangyong	10	371	115,916	74.21	1	1,029,692	3.75%
Hanjin	9	222	3,699	16.91	21	655,107	0.12%
Kia	5	16	617	4.34	25	855,139	0.02%
Hanhwa	8	87	6,687	8.28	23	763,461	0.22%
Lotte	4	508	25,428	44.21	6	1,386,915	0.82%
Kumho	4	275	17,345	39.66	10	823,803	0.56%
Doosan	9	191	4,435	51.29	3	293,476	0.14%
Daelim	5	140	5,027	21.55	20	294,340	0.16%
Hanbo	2	82	267	41.70	8	437,696	0.01%
Donga	4	300	24,291	47.48	4	295,220	0.79%
Halla	3	383	6,502	12.26	22	227,796	0.21%
Hyosung	2	275	4,434	32.45	13	235,697	0.14%
Dongkuk Iron	7	665	21,201	27.34	16	248,636	0.69%
Jinro	4	225	6,030	36.02	11	239,414	0.20%
Kolon	4	287	7,164	22.39	19	283,511	0.23%
Dongyang	4	300	11,472	27.48	15	184,760	0.37%
Hansol	6	316	14,156	26.64	17	246,785	0.46%
Dongboo	8	112	5,736	4.17	26	186,406	0.19%
Kohab	3	433	8,800	28.04	14	267,884	0.29%
Hai-Tai	5	134	4,954	41.73	7	214,852	0.16%
Sammi	2	0	0	0.00	27	386,423	0.00%
Hanil	2	0	0	0.00	27	270,178	0.00%
Kukdong	2	0	1,061	0.00	27	98,380	0.03%
New Core	_	_	_	_	_	143,529	_
Byuck San	4	300	7,586	44.87	5	147,891	0.25%
30 Chaebol average		273	_	18.32	_	22,994,282	_
market average		290	_	21.9	_		

Note:
1. Ranks refer to the order of the 30 Chaebol's Dividends to Net Income Ratio.
2. Correlation coefficient (Dividends to Net Income Ratio, Net Income to Capital Stock)= 0.360137913

Source: Calculations based on the figures from the following sources:
1. Korea Stock Exchanges (reported in Hankyeryo Newspaper, 1996/11/15)
2. Choi, Seungno, Korean Conglomerates in 1997, p144, Center for Free Enterprise.
3. Choi, Seungno, Korean Conglomerates in 1996, p170, Center for Free Enterprise.

Table 8: The Cases of Bankruptcies and the Successions in the Korean Conglomerates

Name of the Firms	Forms of Bankruptcy	Date Bankrupt	Succession	Succession Year
Woo-seong	C.A.	96-01-19	Yes	990
Dong-A	S.L.	97-01-10	Yes	1977
Han-Bo	C.A.	97-01-28	Yes	1996
Jinro	S.L./C.A.	97-03-20	Yes	1984
Sammi	C.A.	97-03-20	Yes	1980
Hanshin	C.A.	97-05-31	Yes	1983
Kia Auto	C.A.	97-07-18	No	N.A.
Dae-Nong	S.L./C.A.	97-09-11	Yes	1989
Ssang-Bang-Ul	S.L./C.A.	97-10-20	Yes	1997
Newcore	S.L.	97-11-04	No	N.A.
Su-San	S.L./C.A.	97-11-18	No	N.A.
Tae-Il	S.L./C.A.	97-11-18	No	
Sin-Ho	S.L.	97-11-28	No	N.A.
Halla	S.L./C.A.	97-12-08	No	N. A.
Hanhwa	S.L.	97-12-16	Yes	1981
Jin-Do	S.L.	97-12-16	Yes	1981
Ssangyong	S.L.	98-01-10	Yes	1975
Hanil	S.L.	98-01-15	Yes	1981
Nasan	S.L./C.A.	98-01-15	No	N.A.
Kukdong	C.A.	98-01-20	Yes	1991
Kohap	S.L.	98-01-30	No	N.A.
Chung-Gu	S.L./C.A.	98-04-23	No	N.A.
Geo-pyung	Default	98-05-20	No	N.A.
Hai-Tai	S.L.	98-11-03	Yes	1981

Notes:
1) S.L. means "Cooperative Syndicated Loans," which is to give emergency loans for the de facto bankrupt firms in the form of syndicated loans by the involved banks. In some cases, the initial S.L. led to the C.A. later. In other words, the cases are often mixed.
2) C.A. means "Court Administration." Those firms, which are assessed to be hopeless even with cooperative syndicated loans, were directly subject to court administration.
3) All firms belong to the top 60 largest conglomerates in terms of the asset values as of the end of 1996, assessed by the Bank Supervision Authority of Korea.

Table 9:
Trends of Effective Protection Rate and Customs Taxes Rate for Manufacturing Goods Imports in Korea

A: Trends of Effective Protection Rate, 1963-1990

(Unit: %)

	1963	1970	1975	1978	1980	1983	1985	1988	1990
Primary Industry	37.3	27.7	31.5	78.7	73.3	86.3	89.6	113.6	160.0
Manufacturing Industry	243.9	15.3	-3.8	9.5	18.6	15.0	8.3	-0.2	4.0
Light Industry	266.8	8.7	-15.1	-5.7	10.7	8.7	-2.5	-13.5	-5.8
Heavy & Chemical Industry	158.7	25.5	6.8	37.4	44.2	26.2	15.2	9.9	12.9

Note:
1) It is estimated by the Corden approach using the sales revenue data. 1963 figures are calculated by Lee Jaemin. The figures for 1970,1975, 1978 are from Kim, Kwang-seuk & Hong Seung-deuk(1982, p.48). The figures after 1980 are calculated using the data from Hong Seung-deuk(1992, p.27, p.29) and the input-output tables by Lee Jaemin.
2) Light industry include food processing, tobacco processing, textile industry, garments and other fiber products, leather, woods products, paper-making and paper products, printing and publishing, rubber products, plastic products, non-mental mineral. Heavy and chemical industry include chemical, petroleum and coal mining and dressing, primary metals mining and dressing, metals dressing and several machinery.
Source: Lee Jaemin (1995)

B: Trends of Customs Taxes Rate for Manufacturing Goods Imports, 1983-1994

(Unit: %)

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Customs Taxes Rate	22.6	20.6	20.3	18.7	18.2	16.9	11.2	9.7	9.7	8.4

Source:
Ministry of Finance, reported in Kim(1996)

Table 10: Profit(Net Income) to Equity Ratio by Size of the Firms (%)

Year	large	medium	small
80	-8.8%	-4.4%	-3.7%
81	-0.2%	0.8%	2.3%
82	-4.5%	2.5%	4.5%
83	7.4%	11.5%	13.9%
84	7.4%	9.9%	10.4%
85	4.0%	8.4%	6.4%
86	16.3%	12.1%	13.9%
87	18.6%	14.6%	15.4%
88	16.0%	14.6%	15.5%
89	11.7%	14.1%	13.0%
90	1.7%	7.0%	8.1%
91	0.4%	7.0%	7.4%
92	-2.0%	1.2%	1.4%
93	2.8%	3.5%	2.9%
94	4.6%	5.9%	5.0%
95	-1.3%	0.4%	2.3%
96	-4.5%	-1.6%	0.3%
Average by period			
1980-84	0.3%	4.1%	5.5%
1985-89	13.3%	12.8%	12.8%
1990-96	0.2%	3.3%	3.9%
1980-96	4.1%	6.3%	7.0%
Standard deviations			
1980's	9.2%	6.6%	6.5%
1990's	3.1%	3.4%	3.0%
1980-96	7.9%	6.0%	5.9%

Source: Yoon(1998).

Table 11: Changing Profitability of the Chablols

A. Profitability of the 30 largest Chaebols in Korea

(Unit: %)

	1994	1995	1996
operation profit / equity	6.23	1.11	0.87
normal profit / equity	0.31	0.42	0.09
operation profit / sales revenue	0.22	0.23	0.17
normal profit /sales revenue	0.07	0.09	0.02
operation profit / total asset	0.22	0.25	0.18
normal profit / total asset	0.07	0.09	0.02

B. Profitability of the 10 largest Chaebols in Korea

(Unit: %)

	1994	1995	1996
operation profit / equity	15.37	28.95	24.66
normal profit / equity	8.46	10.38	0.75
operation profit / sales revenue	6.22	6.23	4.7
normal profit /sales revenue	1.9	2.29	0.21
operation profit / total asset	6.34	6.74	5.02
normal profit / total asset	2.16	2.65	0.4

Source: Calculations based on the data from Cho, Seungno (1995,1996,1997), The large corporate Groups in Korea (in Korean)