

KOREAN BUSINESS: FOCUSING ON BIG BUSINESS

Sung-Woo Lee

Institute for Social Science Research,

Pusan National University

woolistar@gmail.com

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BIG BUSINESS IN KOREAN ECONOMY

- In 2012, total sales of 10 biggest groups = 76.5% of GDP - 946.1 trillion won(\$ 83.1 billion)
- In 2014, total sales of 10 biggest groups = 84% of Korea's GDP
- In 2014, Samsung's revenue = 20.4% of Korea's GDP
- Four next conglomerates(Hyundai, SK, LG, Lotte) added up to 34.6%

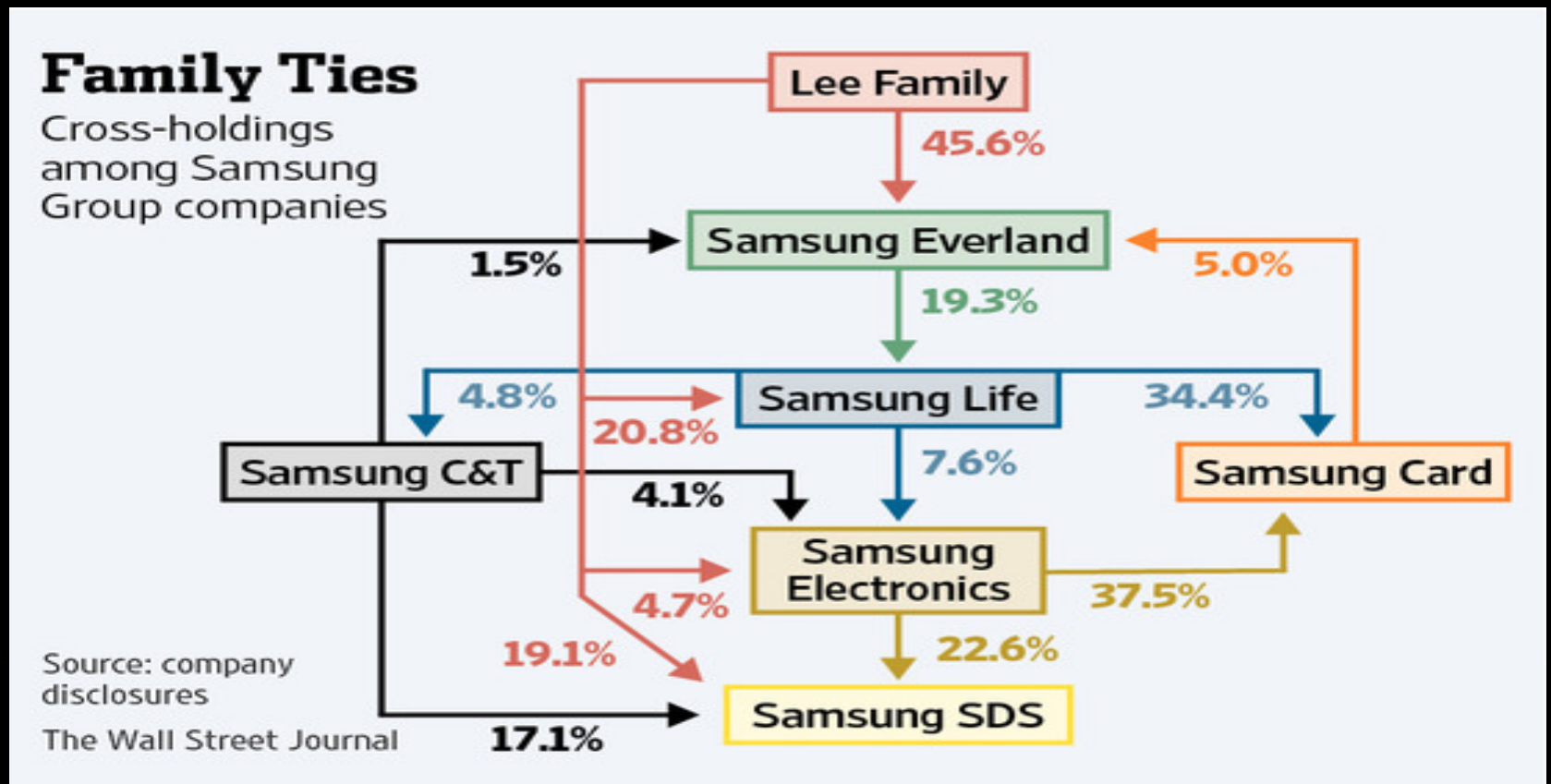
DEFINING KOREAN BIG BUSINESS GROUP

- 'Chaebol' is journalistic term
- Definition : A large diversified business group that is owned and controlled by a family or closed kinship group.
- Family dominance and diversification
- Total assets amounting over 400 billion won (US\$ 500 million when the exchange rate is \$ 1 to 800 won) in 1987
- <revision 1999> : Total assets or amount of annual sales over 2 trillion won(roughly US\$ 1.8 billion when the exchange rate is \$ 1 to 1100 won)

DEFINING KOREAN BIG BUSINESS GROUP

- Three distinct structural elements:

1) Structure of family dominance



DEFINING KOREAN BIG BUSINESS GROUP

2) a holding company control legally independent firms(multi-subsidiaries rather than multi-divisions)

3) A diversified business structure encompassing a number of discrete products and services

DEFINING KOREAN BIG BUSINESS GROUP

- Key elements to big business growth - government support
 - 1) Export-oriented industrialization in labor-intensive and light industries
 - 2) Strong state support in financial allocation in targeted industries
 - 3) The establishment of large business conglomerates during the heavy-chemical industrialization (HCI) phase in the 1970s.
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HISTORY – 1950'S

- Domestic shortages
 - Colonial exploitation policy under Japanese rule
 - Destruction of industrial facilities by Korean war : average 60% per each industries
 - The lack of domestic capital, technology, policies
- Strong state, Weak civil society
 - militarization and Anticommunism (Korean war)
- Economy of assistance by U. S.
 - After 1945, Korean Economy based on U. S. Aids
 - 72.5% of Government revenue(1953—1960) = U. S. Aids

HISTORY – 1950'S

- Two big economic resources
 - Sales of vested properties (“enemy properties”)
 - Allocation of U. S. aid goods and funds
 - Import-substitution industrialization – national economic policy
 - developed consumer goods industries such as textiles, sugar, and wheat flour-processing industries
 - Government selected businessmen who got economic resources
 - the acquisition of Japanese firms and properties at below-market prices
 - privileged access to bank loan (actually, foreign aid funds)
 - import quotas and licenses
 - the acquisition of non-competitive government contracts
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HISTORY – 1950'S

- Rent-seeking and Making political capitalists
 - Major companies disproportionately benefited from a variety of rent-seeking activities
 - Government built up powerful patronage connections
 - non-competitive bidding for government construction contracts
 - the new industrial capitalists – ‘political capitalists’
 - : who took advantage of factional politics to gain economic favors in return for political contributions
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The List of the Major Korean Chaebol, 1960

Chaebol	Major Sectors	Firms	Industries
Samsung	Textile, Sugar	17	14
Samho	Textile	7	5
Samyang	Textile, Sugar	9	8
Kaepung	Machinery, Steel	7	5
Lucky	Chemicals, Electronics	5	5
Daehan	Textile, Sugar, Electronics	6	6
Dongyang	Cement, Sugar, Pharmacy	4	4
Hwasin	Commerce, Textile	5	4
Hanguk Glass	Flat glass	3	2
Keugdong	Oil refinery, Trade	4	3
Hyundai	Construction, Cement	3	3

Sources : Kim, Yun Tae. 2008, 76

HISTORY – 1960'S

- The Consolidation of big business Under the Park Regime : 1961-1979
 - Unbalanced growth strategy – selection and Concentration
 - Promoting big business groups for Rapid industrialization
 - Choice business group and guarantees by government
 - The role of government for economic growth in 1960s
 - Choice the industrialization strategies
 - Government guarantees for commercial loans
 - Control credit distribution over domestic companies
 - Allocating bank credit and foreign loans in the process of trade and investment polices
 - Give Subsidies
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HISTORY – 1970'S

- Export-led The Heavy and Chemical Industrialization
- Targeted industries : steel, electronics, chemicals, shipbuilding, machinery, and non-steel metals
- 'Policy loans'
- 22.8% growth average annual rate of 46 largest business groups(1973 – 1978)
- In 1972, the 30 largest chaebol had on average 7.5 firms, comprising an average of 7.7 different industrial sectors
- In 1979, the 30 largest chaebol owned on average 25.4 firms, spreading on average into 17.6 different sectors in related or unrelated

NEW BUSINESS LINES IN HEAVY AND CHEMICAL INDUSTRIES IN THE 1970S

Big business	Number of firms		New business lines in heavy and chemical industries
	1974	1979	
Hyundai	9	31	Automobile, machinery, shipbuilding, heavy electrical, heavy machinery
Samsung	24	33	Shipbuilding, heavy machinery, electric switching system, electronics
Lucky(LG)	17	43	Petrochemicals, oil refining, electronics
Daewoo	10	34	Automobile, heavy machinery, shipbuilding
Hyosung	8	24	Heavy electrical, machinery, petrochemicals
Kukje	7	22	Iron & Steel, machinery
Ssangyong	17	20	Cement, heavy machinery, heavy electrical
Sunkyong(SK)	8	14	Chemical, machinery

HISTORY – 1980'S

- The result of the HCI(heavy and chemical industry) drive in the 1970s
 - Hyper-inflation
 - Moral hazard of big business by excessive state intervention
 - Debt crisis
 - Corruption
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HISTORY – 1980'S

- Government adopted the economic stabilization policy
 - Restrictive monetary policy(currency control)
 - Cut and freeze the government spending(1983-1984)

 - Economic liberalization and privatization policies
 - Reduction of government intervention in the product and factor market
 - Opening the domestic market
 - Privatizing the financial and public sectors
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HISTORY – 1980'S

- The new opportunities of high-tech industries and foreign direct investment
- The number of market dominant commodities increased threefold throughout the 1980s

HISTORY – EARLY 1990'S

- Democratization
 - Globalization
 - Rapidly Deregulation for join the OECD
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ECONOMIC REFORM AFTER ECONOMIC CRISIS

- Economic crisis of 1997
 - Inefficient management – as a cause of the financial crisis.
 - After crisis, IMF's demands
 - transparency and fair trade
 - supervise the business in ceasing practices of mutual guarantee for payment among their subsidiaries,
 - accepting consolidated financial sheets completely
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FIVE PLUS THREE PRINCIPLES: AN OVERVIEW

	Principles	Institutions and policy
Five Principles (Jan. 13, 1998)	Enhanced transparency	Consolidated financial statements Outside directors (50%) Protection of small shareholders/ collective litigation
	Control intra-group transactions	Ban on inter-subsidiary debt payment guarantees
	Improved financial structure	Reduction of debt-equity ratio to 200%
	Streamlining business lines	Separation and sale of non- specialized affiliates
	Stronger accountability	Accountability provisions for CEOs

FIVE PLUS THREE PRINCIPLES: AN OVERVIEW

	Principles	Institutions and policy
Three Principles (Aug. 15, 1999)	Improve management structure of secondary financial institutions	Limits on cross-equity holding at 7%
	Limit on Chaebol's equity investment	Cap on total amount of equity investment of 25 % of net assets
	Prevention of irregular inheritance and gift-giving	Amendment of related laws
30 Group Designation System	Prevention of economic concentration	Ban of debt payment guarantees Ban on cross-investments

Source: Haggard, Lim and Kim 2003, 132

ECONOMIC REFORM AFTER ECONOMIC CRISIS

- Government dealt with 'the Big Five(Hyundai, Samsung, Daewoo, LG, SK)' through the negotiation of informal, "voluntary" agreements that covered such controversial issues as inter-subsidiary loan guarantees and the reduction of excessive indebtedness.
- Big Deals – corporate restructuring
 - Industry structure reorganization
 - Induce to focusing on essential sector
 - Target industries : semiconductor, petrochemistry, aerospace, railroad car, power plant, shiping engine, oil refining, automobile, electronics

ECONOMIC REFORM AFTER ECONOMIC CRISIS

- Workout plans
 - Apply to the smaller chaebol, those ranked sixth or below in total sales
 - Demand and induce to liquidate and merge of insolvent enterprise(business)
 - Workout program : 54 firms of 17 groups, 39 middle and big business in 1999
 - Liquidation : 55 firms in 1998, 29 firms in 2000

THE OPPORTUNITIES AND CHALLENGES

2012 Presidential candidate's ideas for Chaebol reform

Park Geun-hye
(Saenuri Party)

- Banning Circular equity investment
- Excluding convicted chaebol owners from presidential pardons
- Banning reprieves for crimes like embezzlement, misappropriation

Moon Jae-in
(Democratic United Party)

- Banning Circular equity investment
- Reviving ceilings on equity investment
- Stronger restriction on inter-affiliate transactions

THE OPPORTUNITIES AND CHALLENGES

- Solving Problems : Size, market dominance, a weak legal infrastructure, undue political influence, corruption
 - Ownership
 - Adjustment Relations between the Government and Business
 - Pressures of foreign investor and creditor – demand restructuring groups
 - Control of domestic banks and capital market
 - Intensifying competition
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