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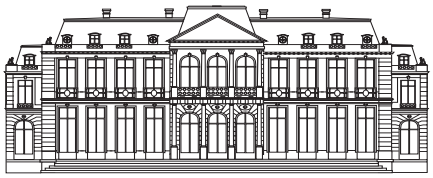

Organisation de Coopération et de Développement Économiques

in co-operation with

the Korea Development Institute

and with the co-sponsorship of the Government of Japan and the World Bank

conference on

"CORPORATE GOVERNANCE IN ASIA: A COMPARATIVE PERSPECTIVE"

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Korea Development Institute

CORPORATE GOVERNANCE IN KOREA

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Part I. The Korean Economy Before and After the Crisis

1. Economic Performance Before the Crisis

1. Korea's rapid growth during the past four decades has been cited as an exemplary model of successful economic development and termed an "economic miracle."[1] Indeed, Korea's growth performance was remarkable as shown by the fact that its per capita income increased by more than 120 times, from a mere US$ 80 in 1960 to US$ 10,543 in 1996.

2. Remarkable economic growth was accompanied by equally dramatic change in economic structure. International trade, including both exports and imports, as a share of GDP increased from 12.9% in 1960 to 88.7% in 1996 (Table I-1). Total investment accounted for only 8.6% of GDP in 1960, but dramatically rose to 39.1% in 1996. On the production side, the manufacturing sector also underwent significant structural change as indicated by the increased share of heavy and chemical industry (HCI) within the sector from less than 20% to more than 70% during 1960-1996.

3. The major thrust for economic take-off was made at the beginning of the 1960s when the newly established government adopted an outward-looking development strategy based on export promotion. Such a development strategy led to increases in employment, income, and savings by enabling Korea to benefit from economies of scale in production and technology transfer as well as to make best use of its available resources. In particular, the promotion of HCIs as strategic export industries during the 1970s expanded the spectrum of the product mix of the economy and provided domestic producers with a good opportunity to benefit from scale economies.

4. The so-called HCI drive in the 1970s set the stage for the emergence of large conglomerates – known as c*haebols* in Korea – which has been the core engine of growth since then. The government provided c*haebols* in the targeted sectors with massive financial support in the form of policy loans that carried low interest rates. To this end, the government directed more than half of the bank credit through state-owned banks. More important was the government's implicit risk sharing with private firms in making investments. These measures significantly contributed to rapid growth which was largely driven by the factor-input expansion.

* The authors gratefully acknowledge the help from Jong-Kil An and Soo-Geun Oh.

[1] Lucas (1993) even constructed a model for the occurrence of economic miracles based on the Korean growth example.

5. High economic growth and rapid industrialization, however, was not free of problems. The government's financial support to and risk sharing with c*haebols* resulted in a serious problem of moral hazard not only in the corporate sector but also financial institutions. Implicit risk-sharing by the government encouraged c*haebols* to make reckless investments based on heavy debt financing, while discouraging financial institutions to properly monitor the soundness of borrowers and manage risk in their loan portfolios.

<Table I-1> Changes in the Economic Structure by GDP

(Unit: %)

	1960	1970	1980	1990	1996
Trade and Investment					
Trade/GDP	12.9	21.7	51.5	60.1	88.7
Investment/GDP	8.6	20.0	28.6	36.9	39.1
Construction	5.7	13.3	16.8	22.1	21.2
Equipment	2.9	4.3	11.7	15.0	16.8
Industrial structure					
Manufacturing/GDP	10.9	10.6	22.1	29.2	30.1
Light Industry	8.8	7.2	11.7	9.9	6.4
HCI	2.1	3.4	10.4	19.2	23.6
Agriculture/GDP	41.6	28.4	15.1	8.7	6.4
Service/GDP	43.2	50.5	48.7	47.6	49.0

Source : National Statistical Office, *Major Statistics of the Korean Economy.*

2. The Impact of the Crisis

6. The impact of the financial crisis that occurred at the end of 1997 was immediately reflected in the currency market. Upon the onset of the crisis, the exchange rate of the won *vis-a-vis* the US dollar soared to a 1,950 level in December 1997, from the pre-crisis level of about 900. In order to stabilize the currency market quickly, the IMF imposed a high interest rate policy during the initial stage of crisis management. Accordingly, the call rate jumped from 14% to 25% and the rise in market interest rates soon followed. Such a drastic rise in interest rates, coupled with 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% increase compared to the same period of the previous year.

7. Massive corporate bankruptcies immediately translated into a dramatic increase in non-performing loans (NPLs) of financial institutions, seriously undermining the soundness of the financial system as a whole. As of the end of June 1998, the estimated total of NPLs of all financial institutions, broadly defined to include loans classified as "precautionary," was

about 136 trillion won (32% of GDP), a 58% increase from 86.4 trillion won at the end of 1997 (Table I-2).

8. The financial crisis quickly degenerated into a full economic crisis. The Real GDP growth plunged since the fourth quarter of 1997, and remained negative throughout 1998 (Table I-3). In particular, private consumption and fixed investment declined drastically, mainly due to the severe credit crunch as well as increased market uncertainty. Reflecting the dire growth performance as well as fallouts of economic restructuring, the rate of unemployment sharply rose to over 7% in 1998, up from the pre-crisis level of 2 to 3%. Stagnated domestic demand, however, worked as the major contributing factor behind the improved external current account as it reduced import demand dramatically. The current account registered a record-high level surplus of more than US$ 40 billion in 1998, while imports declined by more than 20%. Large devaluation of the domestic currency after the crisis pushed up consumer price inflation to 7.5% in 1998, from 4.5% in 1997.

<Table I-2> Non-performing Loans (end of period)

(Unit: trillion won)

			Dec. 1997	Mar. 1998	June. 1998
Non-performing Loans (A)			86.4	117.3	136.0
	Precautionary		42.8	57.7	72.5
	Substandard or below		43.6	59.6	63.5
		Bank	31.6	38.8	40.0
		NBFI	12.0	20.8	23.5
Total Loan (B)			647.4	668.7	624.8
A/B (%)			13.3	17.5	21.7

Source: Financial Supervisory Commission.

<Table I-3> Recent Trends in Key Macro Indicators

(year on year growth rates, %)

	1994	1995	1996	1997	1998			
					1Q	2Q	3Q	4Q
Gross Domestic Product	8.6	8.9	7.1	5.5	-3.9	-6.8	-6.8	-
Private Consumption	7.6	8.3	6.8	3.1	-10.6	-13.0	-12.0	-
Fixed Investment	11.8	11.7	7.1	-3.5	-23.0	-29.8	-29.3	-
(Facility)	23.6	15.8	8.3	-11.3	-40.7	-52.4	-46.3	-
(Construction)	4.5	8.7	6.1	2.7	-7.7	-13.2	-15.8	-
Exports	16.5	24.0	13.0	23.6	26.4	14.4	8.9	-
Imports	21.7	22.0	14.8	3.8	- 25.3	-23.1	-20.9	-
Current account (US$ 100 mil)	-39	-85	-230	-82	108	109	97	-
Consumer Price	6.2	4.5	4.9	4.5	8.9	8.2	7.0	6.0
Unemployment[1)]	2.4	2.0	2.0	2.6	5.7	6.9	7.4	7.4
Dishonored Bill Ratio[1)]	0.17	0.20	0.17	0.52	0.72	0.59	0.55	0.23
Fiscal Budget surplus/GDP[1)]	0.45	0.35	0.28	-1.65	0.002	-2.42	-5.36	-

Note : 1) In level.

3. Causes of the Economic Crisis

9. A myriad of factors have been cited to date as causes of Korea's financial crisis. To get a clear picture of the unfolding drama of the crisis, however, it is necessary to identify the essential characteristics of the crisis. For Korea, the financial crisis was initiated by a series of large-scale corporate failures, starting with Hanbo Steel Co. in early 1997. The string of major bankruptcies was soon followed by unbearable burden of NPLs in the financial sector, which, in turn, greatly undermined international confidence and hence caused massive pull-out by foreign investors from Korea. In sum, the corporate insolvency problem translated into domestic financial crisis, and ultimately caused the external liquidity crisis. Of course, many factors, such as poor corporate governance, heavy exposure to short-term external debt, lax supervision and contagion effect, magnified and/or triggered Korea's economic crisis.

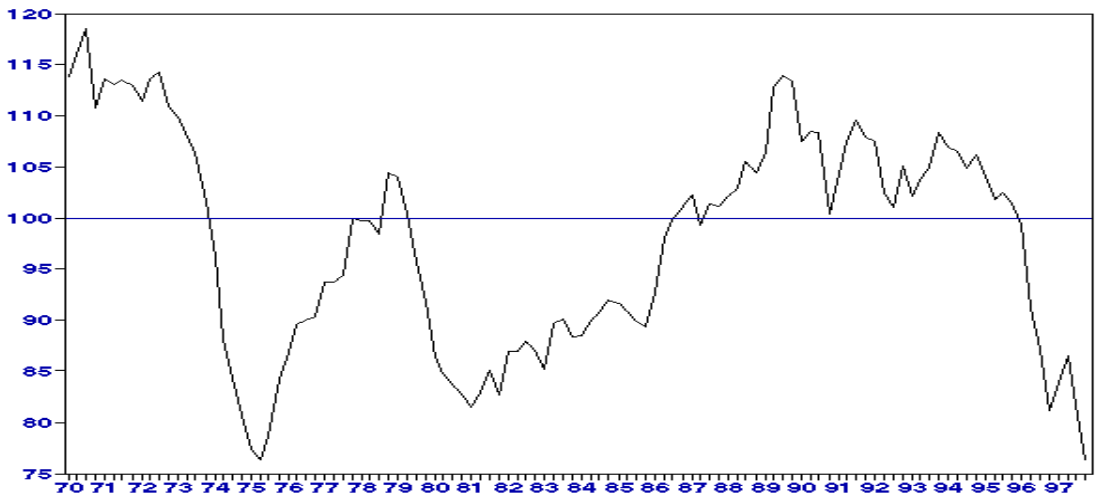
10. At the risk of over-simplification, large corporate failures in 1997 can be attributed mainly to two factors. The first factor is an adverse shock in terms of trade occurring in the first half of 1996, particularly in the semi-conductor manufacturing industry and other HCIs. The terms of trade deteriorated about 20% in 1996, the largest drop since the first oil shock of 1974 (Chart I-1). The unit export price of semi-conductors fell by more than 70% during 1996. Such a negative shock significantly constrained cash flows of *chaebols*, which are the major exporters. The second is structural in nature, namely the heavy exposure to debt financing of large corporations. The weak capital structure of *chaebols*

was the core source of their financial vulnerability. According to the flow of funds statistics, at the end of 1997, gross corporate debt amounted to 811 trillion won, equivalent to about 190% of GDP (Chart I-2).[2] In fact, the ratio of corporate debt to GDP has risen rapidly since the late 1980s, when the current account balance turned into a deficit. Given the large share of international trade, the continued current account deficits have significantly strained corporate cash flows and forced firms to rely more on borrowings to finance operational loss.

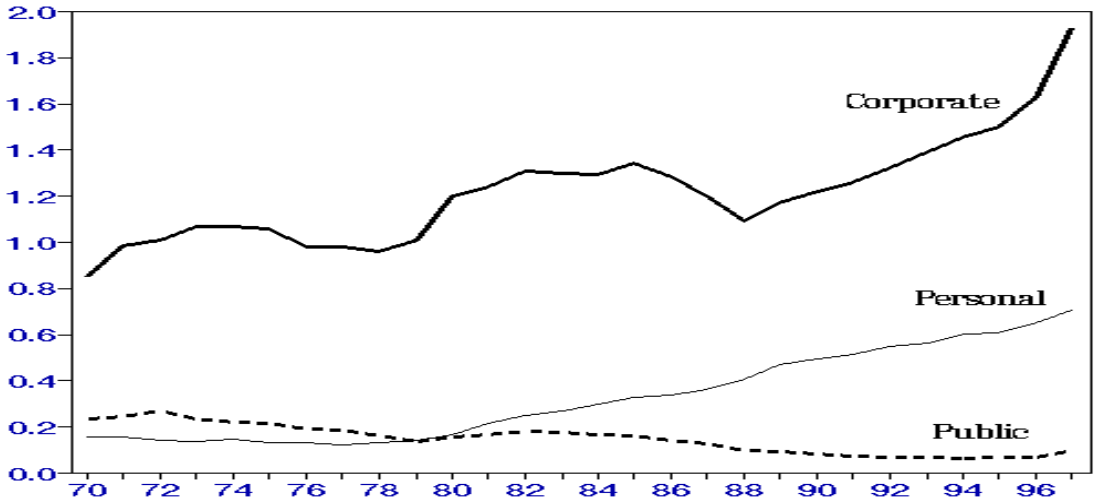
11. The financial vulnerability of Korean corporations can also be seen from the high debt/equity ratios. The corporate debt/equity ratio in Korea is about 5 times higher than that of Taiwan and United Kingdom (Chart I-3).[3] In particular, by the end of 1997, the debt/equity ratio of the 30 largest *chaebols* reached 519%, about 130 percentage points higher than a year earlier. Owing to the high leverage, the ratio of financial expenses to sales in Korea is three times as large as Japan and Taiwan (Chart I-4). Furthermore, the corporate sector's asset-liability composition was quite fragile as evidenced by low liquidity ratios defined as a ratio of liquid assets over short-term liabilities. For Korea, the ratio remains barely above 90 percent, far below that in the U.S., Japan, and Taiwan (Chart I-5).

12. Due to high financial leverage and illiquid asset-liability structure, the corporate sector was faced with high default risk over the business cycle. Such inherent vulnerability was further compounded by large negative shock in terms of trade and weak domestic demand in 1996-97. As a result, 13 out of the top 30 Korean *chaebols* recorded negative net profit in 1996, and 7 of them went bankrupt in 1997, which in turn devastated the banking sector and created an unbearable systemic risk in the financial system.

<Chart I-1> Terms of Trade (Index)

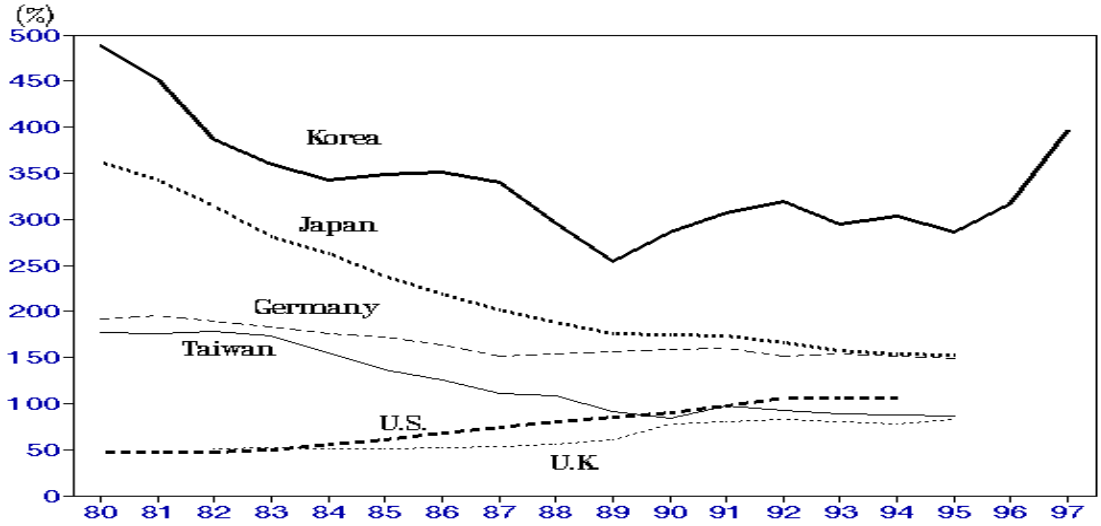


<Chart I-2> Debt/GDP Ratios by Sector : Korea



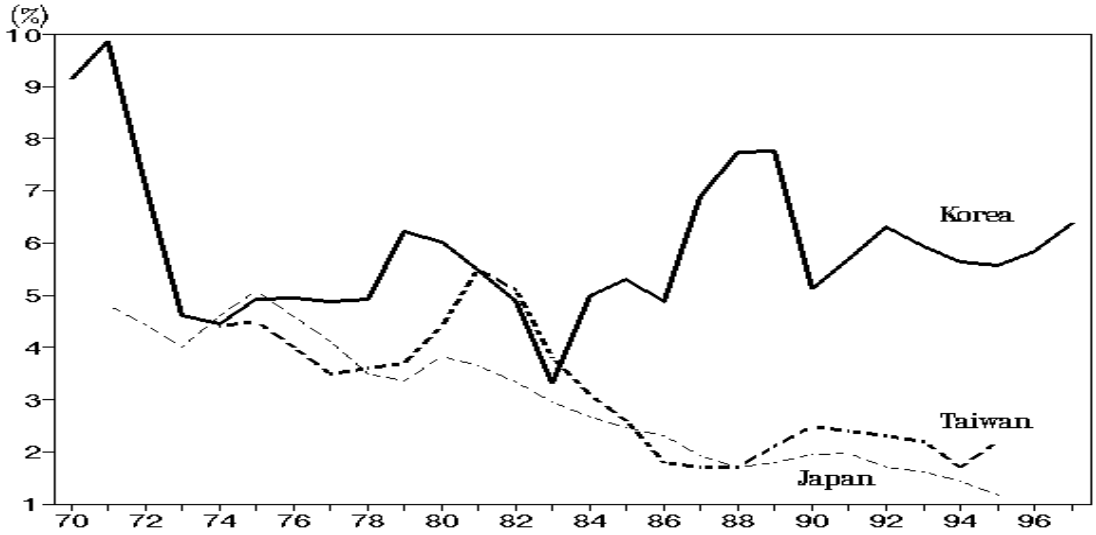
Source : Bank of Korea.

<Chart I-3> International Comparison of Debt/Equity Ratio[1)]



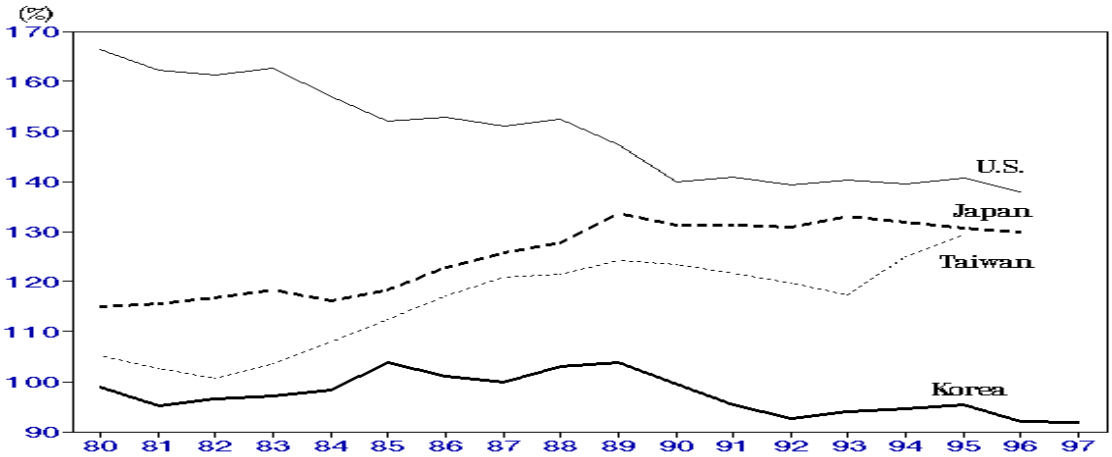
Note : 1) For the manufacturing sector in Korea, Japan and Taiwan.
Source : Bank of Korea, Financial Statement Analysis.
OECD, Financial Statistic Part 3 : Financial Statements of Non-financial Enterprises.

<Chart I-4> International Comparison of Financial Expenses to Sales[1)]



Note : 1) Manufacturing sector.
Source : Bank of Korea, Financial Statement Analysis.

<Chart I-5> International Comparison of Liquidity Ratio[1)]



Note : 1) Manufacturing sector.
Source : Bank of Korea, Financial Statement Analysis.

13. Increased systemic risk in the domestic financial market immediately affected foreign investor confidence. Especially, foreign lenders started to reduce their exposure to Korea as a part of their pull out from emerging markets. Subsequent massive and abrupt capital outflow in the face of falling international confidence was a direct triggering point of Korea's external liquidity crisis. However, the fundamental aspect of the crisis lies at the excessive exposure to short-term external debt and maturity mismatch in the asset-liability portfolios of Korean financial institutions and corporations. At the end of 1996, the share of short-term debt out of total external debt peaked at 58%. The significance of maturity mismatch problems faced by Korean banks is well reflected in low liquidity ratios of less than 80%, which is far lower than the international standard of 100% (Table I-4).[4]

14. The inherent risk associated with disproportionately large share of short-term debt and maturity mismatch was only inadequately covered by foreign reserves. The ratio of short-term external debt to foreign reserves exceeded 200% at the end of 1996, and invariably, all of the crisis-hit countries had high short-term debt to foreign reserves ratios (Table I-5).

15. Korea's excessive exposure to the short-term debt and maturity mismatch problem are the outcomes of a disastrous combination of the ill-sequenced capital account liberalization and lax supervision. Over the course of capital account liberalization since the early 1990s, short-term capital inflows were liberalized in advance of long-term inflows. Consequently, Korean banks borrowed from abroad in the short-term, and lent funds in the long-term, causing a serious maturity mismatch. For example, in 1993, the Korean government relaxed restrictions on the usage for long-term foreign currency-denominated loans, while maintaining restrictions on long-term borrowing, including foreign commercial loans, so as to limit total capital inflows in the face of liberalized short-term borrowing.

16. Another development related to the capital account liberalization was the deregulation on foreign exchange transactions. The number of financial institutions licensed for foreign exchange businesses jumped since 1994. During 1994-1996, Korean banks opened 28 foreign branches while 24 finance companies were newly allowed for foreign exchange businesses upon their conversion into merchant banking corporations (MBCs). These institutional changes in the midst of a strong investment boom during 1994-95 triggered a dramatic increase in short-term foreign debt of financial institutions and severe maturity mismatch problems.

[4] In fact, maturity mismatch had been a chronic problem at least since 1995 (Shin and Hahm, 1998).

17. However, financial supervision of banks and the newly licensed MBCs was lax, if at all, or simply absent. The Office of Bank Supervision introduced a belated guideline for the liquidity ratio of banks only in June of 1997 and the Ministry of Finance and Economy (MOFE), a supervisory authority for MBCs until the eruption of the crisis, had not taken appropriate measures to deal with the problem. In particular, the lack of prudential regulations on MBCs' operations was not confined to the realm of supervision on liquidity conditions. Basic regulations such as capital adequacy ratio requirements had not been applied to MBCs.

18. The importance of the contagion effect as one of the causes of Korea's financial crisis seems to be modest and indirect. Although the Korean economy had a relatively strong trade linkage with the South East Asian region, its financial linkage was not tight despite the modest exposure of domestic financial institutions to that region at the time of financial crisis. Indeed, there is about a 5 month time difference between the crises in Thailand and Korea. Nonetheless, the blanket state of uncertainty in the international financial market triggered by the turmoil in Thailand affected foreign investor confidence in the emerging markets, including Korea. The speculative attack on Hong Kong in October 1997 further increased instability in the international financial market, and indirectly affected Korea in terms of foreign investor confidence. In light of this, the observed correlation between Korea's exchange rate movements and the timing of crises in South East Asia and Hong Kong seems to reflect such an indirect contagion effect (Chart I-6).

<Table I-4> Liquidity Ratios[1)] of the 10 Largest Banks: Distribution

(Number of banks)

	1995	1996	1997. 3	1997. 9
80~90%	1	3	2	2
70~80%	2	2	1	1
60~70%	4	2	4	5
below 60%	3	3	3	2
Average	59.9%	61.7%	62.0%	63.2%

Note : 1) Three-month liquidity ratio defined as a ratio of liquid assets over liquid liabilities, where the period of three-months is a criterion for being ‘liquid’.

Source : Shin and Hahm (1998).

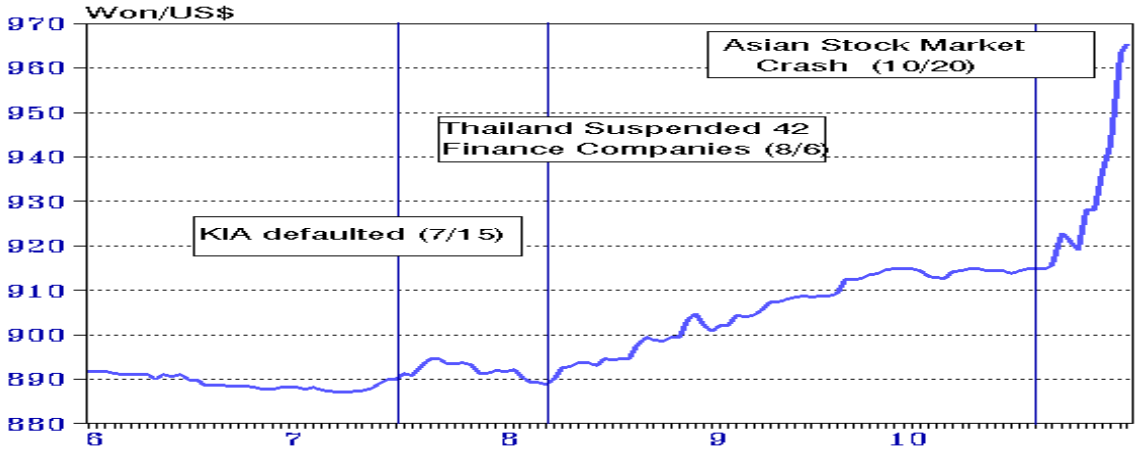
<Table I-5> Short-term Debt/Foreign Exchange Reserves

(Unit: %)

	1995	1996
Korea	171.5	203.2
Indonesia	189.4	176.6
Thailand	114.3	99.7
Malaysia	30.6	40.9
Philippines	82.9	79.5
Singapore	1.8	2.6
Hong Kong	14.2	22.4
China	29.7	23.7
Taiwan	21.6	21.3

Source : BIS, The Maturity, Sectoral and Nationality Distribution of International Bank Lending.
IMF, International Financial Statistics.

<Chart I-6> Movement of Daily Won/Dollar Exchange Rate



4. Policy Responses to the Crisis

19. Korea's crisis management over the past year or so is comprised of three stages. Chronologically, the first stage of crisis management covered the period between the onset of the crisis and April 1998. The first policy priority in the first stage was to overcome the immediate liquidity crisis and stabilize the currency market. Financial assistance from the IMF, the World Bank and the ADB was of great help in resolving the liquidity shortage problem. In tandem with this, the successful debt exchange program negotiated with international lenders as well as the sovereign global bond issues of US$ 4 billion provided an important momentum in crisis resolution. Furthermore, large and sustained surplus in the current account allowed Korea to quickly regain its currency stability. At the same time, high interest policy was instituted as a supplementary measure for currency stability. Thanks to these factors, Korea's usable foreign reserves surpassed US$ 30 billion by the

end of April 1998, while the won-dollar rate stabilized at around the 1,400 level, down from 1,950 in December 1997.

20. Several institutional reforms were also made in the first stage. Legal standards related to corporate governance were strengthened to ensure transparency and accountability in corporate management. On the labor front, labor market flexibility was legally instituted in February 1998, allowing for layoffs due to managerial difficulties. In tandem with this, a Tripartite Commission was established for an open dialogue among labor, business and government in order to ensure fair burden sharing.

21. Having achieved such positive results, the Korean government shifted its policy focus on economic restructuring as the second stage of crisis management that continued until September 1998. During that period, non-viable financial institutions were either closed or suspended, while corporate workout programs were applied to medium-sized *chaebols* who ranked 6th and below. By September, the first round of financial sector restructuring was completed with the help of the government. In total, 94 financial institutions had their operations suspended or were closed down as of the end of September. In the restructuring process, the government provided fiscal support of 41 trillion won (10% of GDP) for the disposal of NPLs, recapitalization of banks, and depositor protection. As a result, most Korean banks obtained BIS capital adequacy ratios of 10-13%. Such improvement in the bank capital structure contributed significantly to the alleviation of the credit crunch.

22. Another important policy measure taken in the second stage of crisis management was the stabilization of domestic interest rates. Given the visible progress in currency stability, the Korean government and the IMF agreed upon the gradual downward adjustment in interest rates. The call rate sharply dropped from more than 20% in the first quarter to less than 9% by the end of September. Such a decline in interest rates, coupled with financial sector restructuring, contributed to the alleviation of credit crunch by reducing corporate default risk and, consequently, prevented the over-kill of the industrial sector. Indeed, in 1998, monthly figures of corporate bankruptcies fell from more than 3,000 in the first quarter to about 1,400 in the third quarter.

23. The second stage also witnessed a dramatic liberalization of the capital market. Restrictions on foreign equity ownership and foreign portfolio investment in the short-term money market were completely eliminated, while hostile M&As by foreigners were fully liberalized. In August 1998, the Foreign Investment Promotion Act was legislated as an institutional basis for attracting foreign direct investment.

24. In the third stage, which began in October 1998, corporate sector restructuring with a special focus on the 5 largest *chaebols*, was intensified on the basis of the visible progress in financial sector restructuring. In the absence of a well-developed capital market, creditor banks were needed to play a major role in corporate sector restructuring, particularly *chaebol* restructuring. Indeed, this was the main rationale behind the Korean government's strategy to tackle the financial sector restructuring first. For the 5 largest *chaebols*, not only debt reduction but also business restructuring was pursued in order to address over-capacity problems. Business mergers and swaps, referred to as the so-called "big deals" were negotiated among the top 5 *chaebols*, and the concrete plans were formulated by the end of 1998.

25. In conjunction with an effort for *chaebol* restructuring, the Korean government implemented an expansionary macroeconomic policy to support economic recovery and supplement the on-going structural reform. In accordance with further stability in the currency market, interest rate reduction was accelerated. Fiscal policy was also expanded to not only finance economic restructuring and the expanded social safety net, but also stimulate domestic demand. To this end, the consolidated budget deficit was allowed to rise up to 5% of GDP in 1998, and this stance will continue in 1999.

26. The visible progress in the financial sector restructuring and economic stimulus from expansionary macroeconomic policies has already been reflected in Korea's brightened macroeconomic picture. Since November 1998, industrial production has been showing an increasing trend, while business operation ratios hovered around 70% in January 1999. Various indicators related to consumption are also exhibiting signs of rapid recovery. These developments in private consumption are partly affected by the wealth effect stemming from rebounded stock prices. More important is the recent upgrade of Korea's sovereign credit standing to investment grade by all major international credit rating agencies. Accordingly, capital inflows have been strong as can be seen in the inward foreign direct investment of about US$ 9 billion in 1998, which far surpassed the annual figures during the previous several years before the crisis.

<Table I-5> Recent Trends in Business Conditions

(Unit: %)

	1998						Jan 1999
	1Q	2Q	3Q	Oct	Nov	Dec	
Production Index[1)]	-6.2	-12.2	-9.5	-9.3	0.3	4.8	14.7
Operation ratio in MFG	68.8	67.0	66.7	69.1	69.6	70.9	69.2
Wholesale and retail index[1)]	-11.2	-16.0	-15.1	-13.2	–8.1	-3.6	2.8
Call rate	23.7	18.7	10.2	7.34	7.26	7.00	6.35
Stock price index	507.8	371.3	317.6	358.8	429.2	524.7	597.6
Wages[1)]	0.1	-1.2	-8.2	-1.4	-1.5	1.3	-
Won/dollar exchange rate	1,613.2	1,394.6	1,325.1	1,335.1	1,292.7	1,212.8	1,174.8
Foreign direct investment[2)]	0.6	1.9	2.2	0.9	1.4	1.9	-
Usable foreign reserve[2)]	241.5	370.4	433.7	452.7	464.7	485.1	500.9

Note : 1) year on year growth rates.

2) In billion U.S$.

Part II. Ownership and Control in the Korean Corporate Sector

1. Distribution of Corporate Ownership

<Ownership Composition>

27. The number of investors has been declining from over 5% of the population in 1990 to 2.9% in 1997. The decline of shareholders is correlated to the weak financial market. After the boom period of the stock market from 1987 to 1989, the Korean stock market has been declining except for a few years of transient recovery. The composition of ownership has also changed. While individual ownership has been declining the most followed by government ownership, both non-financial corporation investors and foreign investors have increased their shareholdings (Table II-1).

28. Most of the changes in the number of investors come from the individual investors as they amount to over 99 percent of total investors. The number of individual investors has been declining from 2.5 million in 1990 to around 1.35 million in 1997. Their ownership has been also decreasing from around 60% in the 1980s to less than 40% in 1997. In terms of market value, individual shareholders owned less than 30% in 1997, indicating that their ownership is relatively more concentrated in inexpensive small stocks.

29. Non-financial institutions represent a huge block of shares through interlocking ownership. Non-financial institutions hold around 20% of shares, most of which are through cross-holding or interlocking ownership. Although some firms are *de-facto* holding companies, there are no laws that recognize holding companies in Korea. In many cases, these institutional owners are the largest shareholders. Recently, their ownership has been increasing in part to protect the incumbent managers from outside takeovers. On average, when the largest shareholder is an institutional investor, their holding is greater than when the largest shareholder is an individual.

30. After reaching its highest ownership percentage of 11.9% in 1989, when the large state-controlled enterprises such as POSCO were listed, government ownership has also declined to 6.6% in 1997. Most government ownership is concentrated in large firms that were completely owned by the state. In the process of privatization of state-controlled firms, the ownership concentration by government has been declining.

31. Financial institutions hold around 20% of total shares, with banks holding around 10%. Other financial institutions including security firms, investment trust companies and insurance firms own more than 10%. Non-Bank Financial Institution (NBFI) ownership has been declining. Among NBFIs, insurance firms have the largest ownership.

32. Foreign investors have increased their shares from 2% to 9.1% by the end of 1997, and constitute almost 13.7% of the total market value (Table II-2). After the crisis, foreign ownership has been increasing fast. By the end of 1998, the value of shares owned by foreigners reached almost 18.6% of total market share. Compared to other countries, foreign investors' ownership in Korea is high.

<Table II-1> Share Ownership by Investor Type

(Unit: %)

End of Year	Government	Banks	NBFIs	Corporations	Individuals	Foreigners	Total
1983	0.20	6.05	4.64	28.96	57.91	2.24	100
1984	0.21	6.61	6.10	31.14	53.74	2.20	100
1985	0.41	7.09	7.35	30.00	52.48	2.63	100
1986	0.15	7.04	12.83	24.53	52.43	3.01	100
1987	0.12	5.61	8.2	20.41	62.35	3.31	100
1988	1.40	6.52	7.8	18.63	62.96	2.69	100
1989	11.84	3.15	10.43	17.85	54.62	2.13	100
1990	10.25	7.34	19.13	15.60	45.99	1.69	100
1991	9.96	8.92	18.67	15.49	44.47	2.49	100
1992	9.20	8.75	19.22	18.77	39.94	4.13	100
1993	8.58	10.72	17.24	17.16	37.57	8.74	100
1994	8.62	10.47	16.74	18.18	36.87	9.11	100
1995	8.03	11.17	15.61	18.65	36.42	10.12	100
1996	7.40	10.55	15.54	20.65	34.29	11.58	100
1997	6.59	9.42	12.27	22.81	39.79	9.11	100

Note : The number of shareholders has been calculated by totaling the shareholders on a record book basis until 1989 and by counting the shareholders since 1990 owning various stocks as one shareholder to prevent to prevent duplication.

Source: Korea Stock Exchange, *Stock*, 1998. 4.

<Table II-2> Stock Distribution by Type of Investors

(Unit: %)

	1996		1997	
	Market Value	Number of Shares	Market Value	Number of Shares
Public sector	10.09	7.4	10.9	6.6
NBFIs	15.2	15.6	12.7	12.2
Banks	10.6	10.5	10.2	9.4
Corporations	19.6	20.6	22.8	22.8
Individual	30.8	34.3	29.6	39.8
Foreigner	13	11.6	13.7	9.1
Sum	100.0	100.0	100.0	100.0

Source: Korea Stock Exchange, *Stock*, 1998. 4.

<Size Distribution of Ownership>

33. Most shareholders invest on a small scale holding less than 500 shares. In 1997, 68% of investors owned less than 500 shares. All together the market value of shares owned by these small shareholders is less than 3% of total market value. Less than 5% of investors own 5000 shares or more. These large shareholders represent more than 82% of the total market value. As shown in Table II-4, the largest shareholder owns over 20% of total shares. Since 1996, ownership by the largest shareholder has increased by more than 5%. Some argue that such increase in ownership is related to an increase in foreign ownership. As foreign ownership reaches a significant level, the existing controlling shareholders are under pressure to defend their control by increasing their ownership stake.

<Table II-3 > Share Ownership by Size of Portfolio

(Unit: %)

	1996		1997	
	Number of Shareholders	Number of Shares[1)]	Number of Shareholders	Number of Shares[1)]
10,000 shares above	1.85	81.55	2.23	76.22
5,000 ~ 10,000	2.00	4.38	2.67	6.37
1,000 ~ 5,000	13.81	9.14	16.17	11.99
500 ~ 1,000	10.21	2.28	10.60	2.58
100 ~ 500	26.35	2.03	26.05	2.20
50 ~ 100	15.58	0.36	14.94	0.37
10 ~ 50	30.20	0.27	27.34	0.27
Sum	100.0	100.0	100.0	100.0

Note : 1) In market values.
Source: Korea Stock Exchange, *Stock*, 1998. 4.

<Table II-4> Ownership Distribution by Size of Investors

(Unit: %)

	1996		1997	
	Number of Shareholders	Number of Shares	Number of Shareholders	Number of Shares
Small shareholders	98.1	73.0	98.5	66.0
(institutional)	1.2	46.9	1.1	33.3
(individual)	96.8	26.1	97.5	32.7
Large shareholders	0.3	21.6	0.2	26.8
(institutional)	0.0	15.7	0.0	18.7
(individual)	0.2	5.8	0.2	8.1
Other shareholders	1.7	5.4	1.3	7.2
(institutional)	0.3	3.1	0.3	4.9
(individual)	1.4	2.3	1.0	2.3
Sum	100.0	100.0	100.0	100.0

Note : Small shareholders mean inventors with less than 1% of ownership.
Source: Korea Stock Exchange, *Stock*, 1998. 4.

34. Since cross-holdings make ownership patterns complicated, it is necessary to estimate the magnitude of ultimate ownership that an investor has. By tracing the ultimate ownership of investors using the method in La Porta et al. (1998) and Claessens et al. (1998), we can examine the ultimate corporate ownership concentration. Table II-5 shows the number of firms that are under the ultimate control of a family or government, and how many firms are widely held. At the 10% cut off rate for ownership concentration necessary for control, more than two-thirds of corporations are under the control of family shareholders. When the cut-off rate increases from 10 % to 20%, there is a huge jump in the number of firms described as widely held. This is mainly due to the fact that many family shareholders have ownership between 10% and 20%. When the cut-off rate for the ownership level necessary for controlling a firm increases, more firms can be described as widely held.

<Table II-5> Control of Publicly Traded Companies in Korea

Cut-off rate	Widely held	Family controlled	State controlled
10%	14.3	67.9	5.1
20%	43.2	48.4	1.6
30%	76.2	20.1	1.2
40%	94.8	3.5	0.9

Note: Number of corporations is 350 including the largest 100 firms
Source: Claessens, Djankov and Lang (1998).

2. Distribution of Control

35. In Korea where business groups (*chaebols*) are prevalent in the economy, direct control by the largest individual shareholder is relatively limited as the ownership concentration is around 10% for large *chaebol*-affiliated firms. However, cross-shareholding by other affiliated firms that own an additional 30% of shares enables the largest shareholder to control the firms (Table II-6). Even though banks and other financial institutions hold more than 20% of shares, they have not engaged in corporate governance because until recently their voting was regulated so as not to affect other shareholders' votes.

<Table II-6> In-group Share Holding Ratio of 30 Largest Chaebols

(Unit: %)

	1987. 4	1990. 4	1992. 4	1993. 4	1994. 4	1997. 4
In-group shareholding ratio	56.2	45.4	46.2	43.4	42.7	43.0
Largest holder and related parties	15.8	13.7	12.8	10.2	9.6	9.3
Subsidiaries	40.4	31.7	33.4	33.2	33.1	33.7

Source: Korea Fair Trade Commission.

36. In-group shareholding rations for 3.4 *Chaebol* groups are summarized in <Table II-7>. The figures in the table confirm that dominant shareholders of *chaebol* companies depended heavily on cross-shareholdings of the affiliated companies. For instance, the dominant shareholder of the Samsung group, one of the largest *chaebols* in Korea, controls more than 46 % of the shares of the companies even though his personal shares are around 4%. Many of the *chaebols* in the table went bankrupt or technically bankrupt or fell into financial trouble in 1997 or 1998. They include Kia, Ssangyong, Hanwha, Halla, Dongah, Donggul, Haitai, Newcore, Anam, Hanil, Keopyung, and Shinho. <Table II-8> describes cross-shareholdings of Samsung group companies.

<Table II-7> In- Group Ownership Concentration

(Unit: %)

	1995	1996	1997
1. Hyundai	60.4(15.8)	61.40(15.60)	56.2(14.6)
2. Samsung	49.3(3.1)	49.01(3.29)	46.7(4.2)
3. LG	41.4(6.7)	39.88(6.73)	40.1(6.1)
4. Daewoo	39.7(6.8)	41.69(6.80)	38.3(7.1)
5. SK	51.2(17.7)	48.64(16.53)	44.7(14.6)
6. Ssangyong	33.1(4.2)	37.03(4.36)	42.0(4.5)
7. Hanjin	40.3(22.1)	41.19(21.06)	41.4(21.1)
8. Kia	21.9(17.7)	25.59(4.55)	30.6(21.0)
9. Hanwha	36.7(5.5)	32.83(6.63)	33.0(6.3)
10. Lotte	22.3(3.5)	22.20(3.39)	22.8(3.4)
11. Kumho	40.3(2.6)	41.86(2.45)	40.1(2.3)
12. Halla	57.8(30.5)	55.56(22.74)	49.5(19.0)
13. Dongah	40.1(20.1)	42.38(16.54)	54.2(12.0)
14. Doosan	51.6(14.6)	48.9914.30)	49.7(13.8)
15. Daelim	37.6(9.3)	33.90(9.35)	34.2(9.1)
16. Hansol		54.27(8.97)	37.3(4.1)
17. Hyosung	43.6(14.3)	44.01(14.56)	44.9(14.2)
18. Dongkuk	46.6(15.5)	50.30(17.95)	51.0(18.5)
19. Jinro	47.2(15.5)	45.58(15.67)	45.8(17.5)
20. Kolon	47.6(12.1)	49.66(11.62)	45.1(8.6)
21. Kohap	46.7(6.0)	46.05(10.01)	39.4(8.6)
22. Dongbue	40.4(15.5)	43.83(13.33)	47.8(14.6)
23. Tongyang	46.1(7.9)	53.06(3.53)	50.1(6.1)
24. Haitai	34.0(5.3)	30.48(3.91)	30.9(6.0)
25. Newcore		99.38(35.55)	98.7(36.4)
26. Anam			42.0(10.0)
27. Hanil	43.1(16.2)	36.29(11.10)	37.4(12.2)
28. Keopyung			59.0(17.5)
29. Miwon	49.8(18.9)		52.5(16.3)
30. Shinho			36.9(13.6)
* Sammi	30.9(13.7)	28.36(15.59)	
* Kukdong	25.0(8.8)	26.48(8.95)	
* Byucksan	41.3(15.1)	36.19(14.98)	
* Hanbo	88.3(88.2)		
Avg.	43.3(10.9)	44.14(10.82)	43.0(9.3)

Note : 1) 'In-Group Ownership' is an weighted average (where the weight is the size of capital) for each
business group of the family ownership shares plus those of subsidiaries.
2) The rank was as of 1997.
3) ( ) is the sum of the ownership by controlling shareholder and family members.
4) For Kia, the largest shareholder is Kia motors.

Source : Korea Fair Trade Commission, Press Release.

Part III. Corporate Governance for Firms

37. A high concentration of corporate ownership and control of corporations by families in Korea have led to governance structures that enable the dominant shareholding families to make key decisions on their own. Appointments of board members are almost entirely at the hands of those families in control of the firms. Thus, there is a possibility of conflict of interests between dominant shareholders/ managers and minority shareholders.

38. Episodes of expropriation are abundant. Even the biggest and most successful corporations that also have significant foreign ownership were engaged in scandalous practices. Considering that foreign investors have a much louder voice than domestic investors in Korea, we expect higher incidences of expropriation by dominant shareholders in corporations with smaller foreign ownership. Table III-1 below summarizes several key features of the measures aimed at protecting shareholder rights, before and after the crisis.

<Table III-1> Key Item of Minority Shareholders' Rights

	Former Commercial Code	Amendments	Securities and Exchange Act
Removal of a Director	5%	3% (Art.385α)	0.5%(0.25%) (Art.191/13α)
Right to Injunction	5%	1% (Art.402)	0.5%(0.25%) (Art.191/13α)
Derivative Suit	5%	1% (Art.403)	0.01% (Art.191/13)
Shareholder's Proposal	-	3% (Art.363α)	1%(0.5%) (Art.191/14)
Demand for Convocation	5%	3% (Art.366)	3%(1.5%) (Art.191/13χ)
Right to Inspect Account Books	5%	3% (Art.466)	1%(0.5%) (Art.191/13β)
Right to Inspect Affairs and Company Property	5%	3% (Art.467)	3%(1.5%) (Art.191/13χ)
Removal of Liquidation	5%	3% (Art.539α)	0.5%(0.25%) (Art.191/13α)

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.

39. In principle, the convening of a shareholders' meeting shall be determined by the board of directors. However, shareholders who hold no less than five hundredths of the total number of the issued shares may demand the convening of a shareholders meeting to prevent majority shareholders' oppression (Commercial Code; CC Art. 366 (1)). In the case of listed corporations, the rights to convene a shareholders meeting is vested in shareholders who hold no less than three hundredths of the total number of issued shares. However, in the case of listed corporations where capital stock is more than 100 billion won, the rights to convene a shareholders meeting is vested in shareholders who hold no less than fifteen thousandths of the total number of the issued shares (Security and Exchange Act; SEA, Art. 191. 13. (4)).

40. The right to make proposals is vested in the shareholders who hold no less than three hundredths of the total number of issued shares and who are entitled to vote for more than six months (CC Art. 363. 2 (1)). While listed corporations approve the right of shareholders who hold no less than one hundredths of the total to make proposals, listed corporations whose paid-in capital is more than 100 billion won require five thousandths of the total shares issued (Enforcement Decree of SEA Art. 84. 21). Shareholders should file a written application with the board of directors, which shall state the matters concerning the proposal, at least six weeks prior to a shareholders' meeting to exercise the right of proposals.

41. To facilitate the exercise of shareholder voting rights and the acquirement of the needed quorum of those large companies with dispersed shareholders, proxy voting is duly recognized under the commercial code (CC Article 368. 3). A proxy who wishes to exercise delegated voting rights must present proper documentation certifying his proxy voting right at the shareholders' meeting. Accordingly, a legal proxy must present sufficient documents to certify the effectiveness of his proxy vote and the shareholder that is delegating his voting right must present a document indicating his willingness to delegate his vote.

42. Shareholders can have as many voting rights as the number of directors to be elected with every share and cast their vote cumulatively for a candidate. For cumulative voting, shareholders with no less than 3% of outstanding stocks shall make the claim for cumulative voting 7 days before a shareholder's general meeting. Cumulative voting aims to enable minority shareholders to elect a director who represents their interests (CC Art. 382-2).

43. Shadow voting regulation required financial institutions to vote with other investors except on some important corporate issues like M&A's. Under this rule, financial institutions could not credibly control and monitor the existing management, as their 'voice' was

limited. Until now, although banks held almost 10% of shares in terms of value, they have not played a major role in corporate governance. Although the regulation was not the sole cause of their inactivity, it may have been an obstacle to financial institutions fulfilling their role of corporate governance agents. With the lifting of this regulation in September 1998, financial institutions now are able to take a more active role in corporate governance. As it is expected that the ownership stake of financial institutional investors will increase because investors, including foreigners, can now establish mutual funds, these institutional investors are expected to more effectively monitor and discipline the firm managers.

44. Cumulative voting, which was not available before, is now allowed. However, it is not mandatory. Some large firms are said to be changing their articles of association to exclude the employment of cumulative voting.

45. As a fiduciary duty of CC Art. 382-3, directors shall perform their duties in accordance with the laws and articles of incorporation. Fiduciary duty was introduced to encourage sound management by reinforcing directors' liabilities. The Commercial Code already has some provisions on directors' duties and liabilities like duty of care (CC Art. 382, Civil Code 681) and direct liabilities to the corporation or the third parties in case of their malperformance (CC Art. 399, 401).

46. The amendment to the Commercial Code treats the person who instructs directors on management matters or executes managerial power with influence on a corporation as a legal director as far as director's liability issues are concerned (CC Art. 401-2).

47. Listed corporations are required to appoint outside directors, whose number is no less than a quarter of total directors (Listing Rules: Art. 48-5). And listed corporations are recommended to have an outside auditor. The Korea Stock Exchange may also publicize listed corporations which do not have an outside auditor (Listing Rules: Art. 48-6).

48. It should be noted that remedies for violations of shareholder rights are not sufficient and well enforced. Even though many believe that self-dealings that reduce the value accruing to minority shareholders are continuing, criminal cases involving breach of trust by managers or dominant shareholders are rare. Further, derivative suits are also rare. The existing few cases have been initiated by an activist group, the *Chamyoyundai*, and not by minority shareholders or lawyers interested in financial rewards from the suits. Financial rewards that each minority shareholder is expected to receive from a class action suit, in the event that he wins, are too small to provide him with enough monetary incentive to initiate a suit. The Supreme Court regulation on legal fees appears to limit the incentives of lawyers to initiate such suits.

49. Data on performance management contracts are generally not available, although *chaebol* families are believed to have been using compensation schemes for top managers of the firms under their control that are not fixed-sum payment types. We expect that incentive bonuses received by top managers of *chaebol* affiliated firms are based more on their contribution to dominant shareholders rather than their contribution to the value of the firm to which they belong. Recently, a *chaebol* announced a plan to apply stock options to the compensation scheme of top managers of affiliated firms. It is important that the plan was announced by the *chaebol* headquarters, and not by individual firms. Four state-owned enterprises covered by a special law on commercial public enterprises, KOGAS, Korea Telecom, Korea Ginseng and Tobacco, and Korea Heavy Industries, are known to use performance based payment schemes for their chief executives. The base salary is around 100 million won, and incentive bonuses are capped by about 200% of the base salaries. In addition, a few banks announced stock option plans for their top executives.

Part IV. Problems with *Chaebols* and Relevant Regulations

50. In Korea, *chaebol* families control many firms that cut across multiple industries. Virtually all large firms are controlled by *chaebols*, except for state-owned enterprises and those owned by foreigners. Thus, a handful of families control a big chunk of the assets available in the economy. <Table IV-1> summaries key features regarding dominance of the economy by *chaebol* families. They control nearly 52% of the total assets (818 trillion won) available in the economy.

51. Dominance of *chaebols* combined with strong controls by a family over affiliated corporations raises the possibility of a type of expropriation that utilizes transactions between the firms belonging to a c*haebol* in diverting resources from one firm to another. For, instance, the dominant family could force Firm A, in which it has a 30% interest, to sign a preferential contract with Firm B, which is 100% owned by it. The most popular types of observed preferential contracts are transactions of goods and services as well as assets at terms that are more favorable to Firm B than prevailing market prices, loans made by Firm A to Firm B at below market interest rates, and loan guarantees.

52. It was quite common in Korea that minority shareholders had to take intolerable risks as the firm in which they held shares made loan guarantees to the other firms controlled by the same family, or lent money directly to them. Considering that most large corporations in Korea are heavily indebted, loans from Firm A to Firm B have essentially the same effect as Firm A borrowing from banks and in turn lending to Firm B at its own risk. Equity participation by connected firms frequently led to similar expropriation. Participation in new equity shares of a connected firm near insolvency amounts to an outright transfer of wealth from participating firms to the firm issuing new equities.

< Table IV-1> 30 Largest *Chaebols* : July 1997

(Unit: billion won)

	Total Assets	Total Sales[a]	Number of Subsidiaries	Number of Listed Subsidiaries

1.Hyundai	59,325(7.25%)	69,798	57	20
2.Samsung	82,438(10.08%)	75,605	80	16
3.LG	45,482(5.56%)	48,635	49	11
4.Daewoo	37,497(4.58%)	38,620	30	10
5.SK	23,998(2.93%)	26,797	46	6
6.Ssangyong	18,305(2.24%)	20,157	25	11
7.Hanjin	17,594(2.15%)	9,972	24	9
8.Kia	14,508(1.77%)	12,038	28	6
9.Hanwha	14,388(1.76%)	10,088	31	7
10.Lotte	7,925(0.97%)	7,209	30	4
11.Kumho	8,551(1.05%)	4,834	26	4
12.Halla	6,657(0.81%)	5,297	18	4
13.Dongah	8,873(1.08%)	5,416	19	4
14.Doosan	6,402(0.78%)	4,046	25	8
15.Daelim	6,810(0.83%)	4,970	21	5
16.Hansol	6,431(0.79%)	2,700	23	7
17.Hyosung	6,131(0.75%)	5,478	18	2
18.Dongkuk	6,764(0.83%)	3,487	17	7
19.Jinro	3,881(0.47%)	1,391	24	4
20.Kolon	4,638(0.57%)	4,471	24	4
21.Kohap	3,810(0.47%)	2,563	13	3
22.Dongbu	6,233(0.76%)	4,856	34	6
23.Tongyang	9,558(1.17%)	3,602	24	4
24.Haitai	3,398(0.42%)	2,716	15	3
25.Newcore	2,803(0.34%)	2,279	18	0
26.Anam	2,792(0.34%)	1,995	21	2
27.Hanil	2,599(0.32%)	1,277	7	2
28.Kupyung	4,963(0.61%)	1,387	22	5
29.Miwon	2,235(0.27%)	2,116	25	5
30.Shinho	2,237(0.27%)	1,223	25	6
	425,226(51.98%)	385,023	819	185

Note: Figures in parentheses are the share of total assets of the corporate sector in Korea (818 billion won). 1996.
Source : Fair Trade Commission. Quoted from Yoo (1998).

53. Simple diversion of funds by a dominant shareholder from a firm under his control was not uncommon in Korea. As long as the diversion does not involve transactions between firms under a unified control, it is not a problem that relates to *chaebols*. However, concentrated ownership by families of the firm in question seems to be a significant factor leading to such diversion. This type of diversion differs from a diversion by an executive who is not a member of the dominant family in that it has to pass the eyes of the dominant shareholder and the other employees. Diversion by dominant shareholders is a result of organized efforts by top employees of the firms, because active and intentional participation by some employees and acquiescences by some others are necessary. This suggests that job security, rewards, and in fact the whole careers of most managers are determined by the *chaebol* families. Professional managers in Korea face an incentive structure that forces them to serve the interests of *chaebol* families and not the interests of the firm or the shareholders.

54. Another key feature is the widespread use of loan guarantees. The following two tables summarize the extent of loan guarantees among the top 30 *chaebols*. Many firms affiliated with the top 30 *chaebols* saw their loan guarantees turned into their own debts as many of the firms whose debts had been guaranteed by them defaulted on debt payments.

<Table IV-2 > Trend of Cross-payment Guarantee of the 30 Largest *Chaebols*

(Loan guarantee/ equity capital : %)

1993	1994	1995	1996	1997
469.9	258.1	161.9	105.3	91.3

Source: Fair Trade Commission and the Federation of Korean Industries

<Table IV-3> Status of Cross-payment Guarantees of the 30 Largest *Chaebols*: April 1997

(Loan guarantee/equity capital: %)

5 largest *Chaebols*	6-10 largest *Chaebols*	11-30 largest *Chaebols*
58.9 (64.7)	153.9 (150.3)	207.1 (200.0)

Parentheses: April 1996.
Source: The Federation of Korean Industries.

55. In Korea, controlling families were in a position to control huge amounts of financial resources that the firms under their control borrowed. Inefficient investment of the borrowed money in large risky projects, as well as other more onerous uses, led many of the large corporations to become insolvent or bankrupt and eventually cost the lending institutions and taxpayers an unprecedented amount.

56. High leverage combined with poor profitability of large firms in Korea may have aggravated the agency problem *vis-a-vis chaebol* families. As many of the firms under their control were heavily indebted and experienced huge amounts of losses, the net values of the firms under their control shrunk quickly, as did the net worth of their shares. Although no accurate figures are available, we conjecture that the net worth of the shares of many *chaebol* families in Korea may be negligible, or considerably small compared to the amount of capital that is under their control today. Nonetheless, they are still tightly in control of large firms and huge amounts of financial resources, most of which came from loans that banks and other financial intermediaries made to the firms under their control. In a sense, many families are able to maintain control of large firms and large sums of borrowed money without having proper ownership that normally justifies control. The families that find themselves in such circumstances may find it even more attractive than before to divert resources from the firms under their control.

57. It is widely suspected that *chaebol* companies could relatively easily transfer financial resources to and from one another as the needs for such transfers arise from the standpoint of the dominant shareholders, and they have actually done so frequently. No accurate figure is available on the amount of money involved in such transfers. Many of the transactions between firms under the single control of a *chaebol* family that result in large scale transfers of wealth may be found to be acts of breach of trust if they are brought to the court and sufficient evidence is presented to the court. For some reason that is not clear to us, there are few cases of breach of trust involving large listed companies, even while almost everybody appears to believe that self-dealings among the companies controlled by the same *chaebol* family have been prevailing.

58. Under such circumstances, the Fair Trade Commission has been the main regulator of self-dealings by *chaebol* families. Article 23 of the KFTC Act includes a clause that declares illegal "undue provision of money, assets, labor, and other transactions involving significant preferential treatment, that are likely to distort competition." In 1998, KFTC twice investigated the top five *chaebols* and found illegal self-dealings that entailed transactions amounting to more than 5.5 trillion won, and subsequently handed down administrative fines amounting 93.1 billion won to the involved companies under the control of the five largest families.

59. Almost all of the cases are restricted to preferential financial deals between companies under the control of the same family, such as exorbitant prices paid for CPs, loans made at below market rates, and delay of payment for assets sold to affiliated firms. The move by KFTC was interpreted by many as a response by the government to the efforts of *chaebol* families who were trying to keep under their control the firms that were in deep trouble and should have declared bankruptcy.

60. The following three tables provide detailed information as to the self-dealing cases. It is worth mentioning that of the 33 firms found to have provided subsidies in the first round of investigation, 27 (81.8% of the total) had recorded profits for the previous three consecutive years. Of the 21 beneficiaries, 17 (81.0%) experienced losses in at least one of the three previous years. Four of the beneficiaries showed negative net values. Results from the second round of investigation included nine firms among the beneficiaries that were insolvent and generally showed a similar pattern to that of the first round. This seems to strongly support the suspicion that *chaebol* families were indeed trying to keep ailing firms under their control by cross subsidizing them with the financial resources of the other affiliated firms.

<Table IV-4> Summary of the Results from the 1st Round of Investigation

Chaebol	Number of Subsidy Providers	Number of Beneficiaries	Estimated Amount of Subsidies (in 100 million won)
Hyundai	35	11	7,706
Samsung	7	9	7,200
Daewoo	6	7	4,229
LG	20	6	10,573
SK	12	2	10,555
Total	80	35	40,263

Source: Fair Trade Commission, 1998.

<Table IV-5> Summary of the Results from the 2nd Round of Investigation

Chaebol	Number of Subsidy Providers	Number of Beneficiaries	Estimated Amount of Subsidies (in 100 million won)
Hyundai	13	7	3,485
Samgsung	2	3	2,000
Daewoo	11	3	415
LG	3	2	682
SK	4	6	8,345
Total	33	21	14,927

Source: Fair Trade Commission, 1998.

< Table IV-6> Summary of Surcharge Imposition on 5 Largest *Chaebols*

(Units: 100 million won)

Chaebol	1st Round of Investigation	2nd Round of Investigation
Hyundai	226	92
Samgsung	114	30
Daewoo	89	44
LG	102	22
SK	191	21
Total	722	209

Source: Fair Trade Commission, 1998.

61. While KFTC regulation on self-dealings between *chaebol* companies seems to be the only working mechanism that could check self-dealings by *chaebol* families, it has several shortcomings. First, the logic behind Article 23 of the KFTC Act is basically a predation argument, and is not per se related to expropriation of minority shareholders. Transactions between two firms under the control of a single family that divert resources from one firm to another may at the same time have elements of predation in intents as well as effects. In such cases, KFTC should pursue predatory act cases. But, this should not limit other branches of the government from pursuing breach of trust, or other more onerous acts.

62. Second, from the perspective of corporate governance, the current regulation may be pointing fingers at the wrong parties. Currently, it is the firm that pays the fines, which is consistent with the predation logic of the regulation. However, the firm and minority shareholders will doubly suffer from self-dealings that are detrimental to them in the first place, and from fines that further aggravate their interests. From the perspective of corporate governance, it is the members of the *chaebol* families involved who should pay the fines. Lastly, KFTC regulation on self-dealing does seem to cover only a small part of the potential violations. As the result of the investigations that occurred in 1998 suggest, KFTC may have focused upon only the financial transactions.

63. Other measures that the Korean government has taken include reduction in debts held by *chaebol* companies, reduction in loan guarantees, and consolidated financial statements. *Chaebol* companies are required to reduce their debts to 200% of their equity or below by the end of 1999. *Chaebols* are also required to submit combined financial statements, which show transactions between affiliated firms, starting from the 1999 fiscal year. Although the government also required *chaebol* affiliated firms to eliminate existing loan guarantees, there is room for extension of the loan guarantees.

64. There also has been a relaxation of regulations on *chaebols*. Holding companies are now allowed. However, we see little potential benefits *chaebols* could reap by establishing holding companies to control affiliated firms that are already under their control. In addition, the limits on cross-holdings have also been lifted.

Part V. Foreign Investment and Takeover

65. In May 1998, the investment ceiling imposed on foreign ownership of listed companies was abolished. For state controlled enterprises, the aggregate ceiling has been raised from 25% to 30%, while the individual ceiling remains at 3%. Over 60% of investors are institutional investors and almost 50% of the investors are from the US or UK (Tables V-1 and V-2). Around 15% of foreign ownership is through direct investment rather than portfolio investment (Table V-3).

<Table V-1> Foreign Investment Registration by Country

(As of Dec. 31 1998)

U.S.A.	U.K.	Taiwan	Japan	Others
3,225	859	514	677	3,205

Source : Korea Stock Exchange.

<Table V-2> Type of Foreign Investors

(As of Dec. 31, 1998)

Institutional Investors							Individual Investors	Total
Fund	Pension Fund	Banks	Securities	Insurance	Others	Sub Total		
3,763	522	282	285	159	318	5,329	3,151	8,480

Source : Korea Stock Exchange.

<Table V-3> Foreign Investment in Stocks

	Amount (billion won)	Ratios
Portfolio Investment	22,536.8	16.35%
Direct Investment	3,103.1	2.25%
Total	25,639.9	18.60%

Source : Korea Stock Exchange.

66. Commercial code allows a company to require transfer of shares to be approved by the board of directors as long as such requirement is specified in the articles of association of the company. However, for listed companies, such requirement is prohibited. Thus, transfer

of shares do not have to be approved by the board of directors for listed companies.

67. The old stock exchange act required that anyone whose proportion of shares is expected to exceed 25% as a result of a purchase of shares should acquire more than 50% of the shares of the company. While this restriction was advocated to give shareholders equal treatment, it in fact was used as a barrier to takeovers. A revision of the act in February, 1998 removed the restriction. The dominant shareholding family of the SK group purchased more than 25% of the SK Securities after the revision took effect.

68. The most important existing restriction on takeovers is a restriction called the "5% rule" (Securities Exchange Act Article 21), whereby anyone whose shares in a company reaches 5% or more as a result of a new purchase of shares in OTC should purchase them through tender offers in OTC.

69. In addition, all the mergers and acquisitions are subject to the Fair Trade Act, which forbids merger and acquisitions that would substantially reduce competition in the affected markets. FTA also requires that large companies or dominant shareholders of the companies inform the Fair Trade Commission if either the company or the dominant shareholder purchases 20% or more shares of other companies.

70. Tender offers and hostile takeovers are very rare in Korea and have never been used for large firms. Only a handful attempts at hostile takeovers have taken place. The best known cases involve two merchant banking companies.

Part VI. Corporate Governance of Public Enterprise in Korea

71. There are many public enterprises in diverse forms in Korea. This report covers only the public enterprises that are subject to The Framework Act on the Management of Government-Invested Institutions and the other large commercial companies in which the government maintains controlling shares and also plays an active role. Among the commercial public enterprises that are not subject to the Framework Act, Korea Telecom (KT), Kogas, Korea Ginseng and Tobacco (KT & G), and Korea Heavy Industry (KHI) which used to be a monopoly in the electricity generating equipment manufacturing industry are subject to The Act on Privatization and Management Reform of Public Enterprises (special act henceforth) as well as company laws. The rest of the large commercial public enterprises that are not subject to either act are subject only to company laws. Most of the important public enterprises, such as the monopolistic firms in the network industries such as electricity, telecommunications, and gas as well as in other industries such as tobacco, steel, and electricity generating equipment are covered. Large commercial public enterprises that are not subject to either act include Posco and KBS.

72. Before fall 1997, most of the public enterprises were subject to the framework act, run virtually as instruments of the policies of the line ministries and generally considered as parts of the line ministries. In addition to the framework act, most of the public enterprises were also subject to a special act for each public enterprise that explicitly specified the objectives of the public enterprise as the promotion of public goals in the relevant industry and allowed the line ministry full control of the public enterprise. Appointments of chief executives were almost entirely restricted to career bureaucrats and career politicians with little or no experience in commercial business. Thus, there was little room for utilizing commercial potential of public enterprises. The main objective of the framework act was to prevent inefficiency within public enterprises by letting the Ministry of Finance and Economy, apart from the line ministry, take part in the management of public enterprises. However, since the Ministry of Finance and Economy was not staffed with experts in the relevant industries, its role was restricted. In essence, the idea behind the framework act was to minimize expenditures needed to supply the services of public enterprises, just as the budgetary agency wanted to minimize the cost of supplying government services such as defense. The framework act required that the board of directors of a public enterprise subject to the act include one representative from the line ministry, and another from the Ministry of Finance and Economy. The rest were selected from mostly academics. But, the director from the line ministry dominated, and the others did not play significant roles.

73. A comprehensive study of public enterprises conducted in 1994 and 1995 concluded that privatization was needed for some of the large public enterprises including Korea Telecom and Korea Tobacco and Ginseng. However, the government did not privatize them and instead introduced the special act in the fall of 1997. The act identified four public enterprises mentioned above as the targets for privatization and allowed profit oriented management for them. Specifically, the act exempted KT, KT & G, and Kogas from the framework act and required that their boards consist of executive directors and outside directors who are not government officials, thus excluding the presence of the line ministry as well as the Ministry of Finance and Economy. At the same time, the government abolished the KT act and KT & G act, freeing them from the intervention by the line ministry. Outside directors have been subsequently appointed and were given the tasks of formulating management contracts with the chief executives that are partially based upon the commercial performance of the companies. The act is believed to lead to substantial improvement in the internal efficiency of the four public enterprises. However, its effect has been limited mainly because realignment of industrial policies and the regulatory policies have not been followed. For instance, while the act nominally gave profit incentives to KT, no independent regulatory authority, scheme for rates or access changes for the telecommunications have been established. The line ministries were able to continue to influence the management of public enterprises because they were allowed to appoint outside directors.

74. In late 1998, the framework act was modified to model the special act. On the surface, the public enterprises that are subject to the framework act have similar corporate governance structures as the four companies covered by the special act. However, because the public enterprises that are subject to the framework act are considered instruments of promoting policies rather than commercial entities, there remains confusion as to how to separate policy functions from the more commercial functions of the public enterprises. This confusion is compounded by the fact that the framework act covers many public enterprises which are vastly different in their nature. For instance, the nature of the business of Kepco is as commercial as that of Kogas or KT while on the other hand, Farming and Fishing Promotion Corp. supplies services that are essentially government services with little commercial potential.

75. Overall, corporate governance in the public enterprises in Korea has not changed fundamentally from the old regime that was based upon the view that public enterprises are instruments of the line ministries in its pursuit of public policies. Policy objectives have not been clearly separated from commercial businesses and still influence the operation of public enterprises significantly. In network industries, no independent regulatory framework has been established even though the government identified KT, Kepco, and Kogas as targets of privatization and introduced competition in the telecommunications industry and parts of the electricity industry. Consequently, public enterprises are still run as tools to achieve the goals set by the line ministries and are not allowed to maximize shareholders' value even when sizable shares are in private hands. Lack of separation between public objectives from commercial operation of public enterprises have in the past, and still is, hindering privatization.

Part VII. Debtor and Creditor Relations

76. Corporate finance in Korea is characterized largely by the bank dominance as is the case in most East Asian (EA) countries. The lack of a well-developed capital market was the major factor behind such an unbalanced financing pattern. Under this circumstance, the

primary responsibilities for corporate monitoring rested on creditor banks. However, the reality was neglected monitoring and oversight by banks, the high price of which culminated in the financial crisis. These deficiencies in debtor and creditor relations are closely intertwined with the prolonged state control in the financial sector and the resultant problem of moral hazard. The ownership structure of financial institutions, which varied significantly across the segments of the financial sector, also acted as an important ground for improper debtor and creditor relations.

1. State Control and Moral Hazard

77. Neglected monitoring and oversight of corporate finance by creditor banks in Korea was the natural outcome of the distorted incentive structure which was largely affected by the policy environment, characterized by undue state influence in credit allocations as well as lax financial supervision and regulatory framework. In Korea, unhealthy links between government and banks were a legacy of government-led economic development.

78. Since the early 1960s, the Korean government has played a pervasive role in financing industrial development.[5] The Korean government directly owned all major banks in 1961, directed policy loans to priority sectors such as export industries 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 VII-1).

79. 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 out of total loans extended by deposit money banks (DMBs) remained about 60 percent in 1987-91.

[5] 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 VII-1> 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.

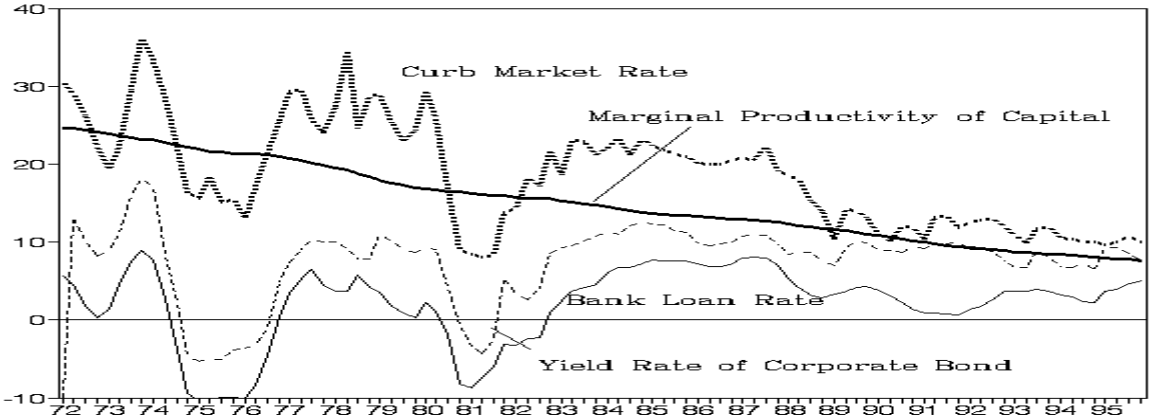
Source : National Statistical Office, *Korean Economic Indicators*, various issues: Bank of Korea, *Monthly Bulletin*, various issues.

Quoted from Y.J. Cho and J.K. Kim (1995).

80. The provision of subsidized credit, coupled with interest rate control, encouraged the corporate sector to rely more on borrowings than equity financing. Since real interest rates have remained below the marginal productivity of capital, over-seas borrowing has taken place, and the subsequent increases in financial expenses induced further borrowing (Chart VII-1). Such a vicious cycle ultimately led to an unbearably high leverage and reckless capacity expansion in the corporate sector.

<Chart VII-1> Real Interest Rate, 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 1/3 and depreciation rate of 0.065. We also estimate the potential GDP and capital stock derived from the KDI quarterly model.

81. The Korean government had to provide an implicit guarantee on bank lending as it played a major role in credit allocation. Also, given the tight linkage between the banking and corporate sectors, corporate failures had an immediate impact on the soundness and viability of banks. For these reasons, the government undertook major corporate bailout exercises on numerous occasions, including the August 1972 Emergency Measure, industrial restructuring in major HCIs (1979-81), and industrial rationalization measures in overseas construction and shipping industries (1984-88).[6]

82. 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 becoming 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.

[6] 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.

83. As the August 1972 Measure set the precedent for corporate bailout, similar rescue operations by the government followed on several occasions.[7] 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 *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.

<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

[6] As discussed below, following the August 1972 Measure, the Korean government introduced various policy measures geared toward reducing debt leverage and improving corporate governance through tightened credit control on large industrialists 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.

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, 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 of banks 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; Korea faced its 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 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).

84. These fault lines, left as a legacy in Korea, have made the business sector vulnerable to unfavorable cyclical shocks and increased systemic risk in a globalizing financial market. Indeed, a series of corporate bankruptcies in 1997, which constituted a starting point of Korea's financial crisis, were not immune to the large terms of trade shocks that occurred in 1996 and 1997 and the subsequent squeeze in corporate cash flows.

85. After the August 1972 Emergency Measure, credit control on *chaebols* was introduced in

order to check or reduce the bank's exposure to *chaebols*, and improve the capital structure of *chaebols*. To this end, various financing restrictions, including the basket control of credit supply, were imposed on *chaebols* and the main bank system was established to implement those restrictions. To some extent, these policies have produced positive results as can be seen in the declining share of bank loans to *chaebols* in total bank lending (Table VII-2).[8] In addition, under the main bank system, the power balance between banks and *chaebols* was improved in favor of banks.

<Table VII- 2> Share of Loans to the 30 Largest C*haebols* by Financial Institutions

(Unit: %)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Banks[1)]	28.6	26.3	24.2	20.7	19.0	18.9	17.9	15.6	15.0	13.9
NBFIs	-	-	32.4	36.6	37.8	38.5	40.5	-	-	-

Note : 1) include deposit money banks only.
Source : The Bank Supervisory Board, The Korea Investors Service, Inc
Quoted from S.M. Yoo and J.K. Kim (1993) and D.H. Lee et. al (1998).

86. Unfortunately, however, the credit control system under the leadership of main banks was ill-focused and, as a result, distorted the debtor-creditor relations. Main banks acted more as a regulator on *chaebol*'s business activities than as a risk-sharing partner in terms of financing. Since the early 1980s, *chaebols* were required to get pre-approval from main banks on their business decisions regarding market entry, investments, acquisitions of assets and real estate holdings, among others, which are not principal activities of banks. In short, main banks acted as *de facto* government agents in terms of regulation and monitoring.[9] Furthermore, main banks were designated by the government on the basis of the bank's exposure to *chaebols*: for each *chaebol*, the government designated a bank, who has the largest exposure to that *chaebol*, as the main bank of the *chaebol*. Once designated, however, the main bank was not changed even if the main bank lost its status as the principal source of credit to the *chaebol*. In retrospect, these features of the main bank system distorted the commercially oriented links between creditor banks and *chaebols* as well as incurred substantial costs and administrative burden to banks. Thus, it is clear that the relationship between the main banks and their *chaebol* clients is in sharp contrast to that of Germany and Japan.[10]

[8] In contrast, concentration of loans to the top 30 *chaebols* extended from NBFIs is greater than that from DMBs, and has been intensified as NBFIs were subject to less stringent regulations, as discussed below.

[9] S.M. Yoo and J.K. Kim (1993).

[10] J.K. An (1995).

2. Ownership and Governance Structure of Financial Institutions

87. Ownership structure of financial institutions is also 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.

< ***Commercial banks*** >

88. In Korea, the social concern about the strong economic influence of *chaebols* translated into strict restrictions on bank ownership structure. In 1982, when the privatization of the banking sector was pursued, a ceiling of 8% 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, as financial liberalization made progress[11]. It has been allegedly argued that the resulting fragmented ownership structure significantly reduced the room for potential influence of large shareholders.

89. As of the end of 1996, the average number of shareholders who own more than 1% of the total voting stocks was 10 for the nationwide commercial banks, and their combined shares accounted for 39.3% of the total. The number of shareholders with ownership of 4% or more averaged at 3, accounting for 24.3 percent of the total shares (Table VII-3). If similar statistics are calculated for all DMBs including local banks whose ownership structure is much more concentrated than nationwide banks due to a higher ceiling, the combined shares of the largest 12 shareholders accounts for more than 40% of the total.

[11] For local banks, there had been no restrictions with respect to ownership structure until 1992 when a 15% ceiling was introduced and has remained at that level up to date.

<Table VII-3> 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 parentheses indicate the number and ownership share by private industrial capital

(including affiliated financial institutions).

Source : The Bank Supervisory Board.

<Table VII-4> 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	Hank 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

90. This figure indicates that the ownership distribution of Korean banks is no less concentrated than in the case of advanced countries such as the United States. Therefore, the long-time advocated argument that "there is no accountable owner in individual Korean banks due to fragmented ownership structure" seems to be unfounded. Theoretically, it only refers to the absence of a *single* dominant shareholder, and should not be interpreted as the non-existence of shareholders with a potential for management control power.

91. Despite Korea's 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. Such behavior of large shareholders has been attributed in large part to government intervention in bank management. Despite financial liberalization and deregulation, strong inertia of government intervention continued as the government appointed CEOs of banks. Under these circumstances, bank management tended to reflect the government's intention in their decisions, rather than being accountable to their shareholders. *The continued government control or influence on banks seems to be a rather unique feature of the Korean banking sector, given the fact that the government did not have ownership in commercial banks after privatization*.

92. Accordingly, internal governance of banks remained ineffective and poor. The board of directors of banks has not been in a position to check the management in an independent manner. Typically, the board of directors was comprised mostly of insiders and the CEO, not the shareholders, who exercised virtually full power in the nomination of directors. In addition, inside directors were actually in charge of carrying out the business plans rather than continuously monitoring the CEO. Although there existed 6 to 8 non-executive directors in case of large nationwide banks, they were not assigned a clearly defined role, nor provided with necessary information for monitoring.

93. To correct this problem, the government revised the General Banking Act at the end of 1996 to introduce a non-executive director-led board system for banks without dominant shareholders.[12] Due to this change, the number of non-executive directors at large nationwide banks increased to 13, while 5-8 non-executive directors were newly appointed at regional banks (Tables VII-5 and VII-6). However, the renewal of the board system itself did not appear to contribute much to the improved bank management. In fact, for the 6 largest banks, 10 non-executive directors who were representatives of shareholders only held 2.64-9.25 percent of total stocks and many non-executive directors seemed to have a favorable relationship with top management. More importantly, at the outset, bank managers did not have strong incentives for improving transparency standards and being accountable to shareholders and outside stakeholders because of weak prudential regulation and moral hazard.

[12] In the system, more than half of board members should be non-executive directors, and they were consisted of representatives of large shareholders (50%), representatives of minor shareholders (30%), and financial specialists (20%). Any person related to one of the 5 largest *chaebols* and institutional investors were not eligible for directorship.

<Table VII-5> Board of Directors of Banks

(As of March 11, 1997, Unit: person)

	Chairman	Managing Director	Executive Director	Director	Auditor	Total	Non-Executive Board Member			
							President	Vice-president	Director	Auditor
Chohung	1	1	10	-	1	13			13	
Commercial	1	2	9	-	1	13			13	
Korea First	1	2	5	4	1	13			13	
Hanil	1	2	9	-	1	13			13	
Seoul	1	1	6	4	1	13			13	
Korea	1	2	9	-	1	13			13	
Exchange	1	1	10	-	1	13			13	
Kookmin	1	2	3	3	1	10	1	1	30	2
Shinhan	1	2[1)]	3	1	1	8			9	
KorAm	1	1	5	-	1	8	1		14	
Dongwha	1	1	5	-	1	8			8	
Dongnam	1	1	3	2	1	8			8	
Daedong	1	1	3	2	1	8	1		9	1
Hana	1	1	4	2	1	9	1		8	
Boram	1	1	2	-	1	5	1		7	
Peace										
Nationwide Banks Subtotal	15	21	86	18	15	155	5	1	184	3
Daegu	1	1	5	-	1	8			8	
Pusan	1	1	5	-	1	8			8	
Chungchong	1	1	3	-	1	6			8	
Kangwon	1	1	5	-	1	8			8	
Cheju	1	1	2	1	1	6			6	
Kyonggi	1	1	4	-	1	7			8	
Jeonbook	1	1	4	-	1	7			8	
Kangwon	1	1	3	-	1	6			7	
Kyungnam	1	1	5	-	1	8			8	
Chungbuk	1	-	3	-	1	5			5	
Local Banks Subtotal	10	9	39	1	10	69			74	
Total	25	30	125	19	25	224	5	1	258	3

Note : 1) Including one first vice-president.

Source : The Bank Supervisory Board.

<Table VII-6> Newly Employed Non-Executive Directors of Banks

(Unit: person, %)

	Classification	Large Shareholders	Minor Shareholders	Recommended by Board of Directors	Total
Nationwide Bank	Corporate	41(38.3)	28(26.2)	8(7.5)	77(72.0)
	Academic circles	1(0.9)	-	7(6.5)	8(7.5)
	All sorts of Organization	6(5.6)	4(3.7)	1(0.9)	11(10.3)
	Lawyer/Accountant	-	-	3(2.8)	3(2.8)
	The Press	2(1.9)	-	1(0.9)	3(2.8)
	Government/Others	-	-	3(2.8)	3(2.8)
	Financial circles	-	-	2(1.9)	2(1.9)
	Subtotal	50(46.7)	32(29.9)	25(23.4)	107(100.0)
Local Bank	Corporate	35(47.3)	14(18.9)	8(10.8)	57(77.0)
	Academic circles	1(1.4)	1(1.4)	5(6.8)	7(9.5)
	All sorts of Organization	2(2.7)	4(5.4)	1(1.4)	7(9.5)
	Lawyer/Accountant	-	-	2(2.7)	2(2.7)
	The Press	-	-	-	-
	Government/Others	-	-	-	-
	Financial circles	-	-	1(1.4)	1(1.4)
	Subtotal	38(51.4)	19(25.7)	17(23.0)	74(100.0)

Note : Figures in parenthesis indicate shares of total non-executive directors in commercial banks.
Source : The Bank Supervisory Board.

94. In fact, the supervisory authorities had never allowed any financial institution to fail before the crisis, for fear of impairing public confidence toward the financial system and their being responsible for inappropriate supervision. At the time of financial distress, the government almost surely rescued ailing institutions. In addition, the information disclosure system fell short of the International Accounting Standards (IAS). As a result, bank managers, recognizing that they would not be forced out of the market even when they were failing, did not actively search long-term development plans to survive in deteriorating environments or carry out restructuring through mergers or strategic alliances. Instead, they relied on high charter value of their banks resulting from various entry barriers, and often appealed to supervisory authorities for relaxing regulatory standards and corrective measures when the business environment worsened.

95. Various factors virtually prevented market discipline from operating properly in the domestic financial markets. High entry barriers restricted fair competition among financial institutions and induced bank managers to maintain a passive management attitude, seeking rents from the imperfect competition. Moreover, exiting management improvement

measures were often not taken by supervisory authorities or were delayed because of unclear standards for taking actions. Also, the capital market could not check the bank management, since accounting data on the financial situation of banks were quite inaccurate,[13] and public disclosure of financial information on banks was hardly sufficient. The market for corporate control in which failing institutions could be resolved through M&As was non- existent.

96. For these reasons mentioned above, bank management was accountable to no one, except the government, even after privatization in early 1980s. Within banks, lending decisions tended to be centralized in senior management, while internal risk control as well as credit analysis skills and procedures were underdeveloped. Given the high corporate leverage and opaque ownership and control linkages, many corporate borrowers were not creditworthy by traditional criteria. As a result, credit decisions tended to rely on collateral and cross debt guarantees among affiliates of business groups rather than projected cash flows. Loan review processes and management information systems were rudimentary. In sum, financial liberalization has expanded the controlling power of bank managers, but at the same time, the lack of proper governance structure, both internal and external, increased the possibility of exploitation and misuse of the expanded power. In light of this, Korean banks not only suffered from greater agency costs, but also played an inactive role as an external governance device against the non-financial corporate sector.

97. Weak external governance by financial institutions on the corporate sector can also be partly explained by the regulations with respect to banks' equity participation in non-financial firms. Korean banks had been regulated in their equity shares in non-financial businesses with a ceiling of 10%. In 1998, the ceiling was relaxed to 15%, and commercial banks increased shareholdings of non-financial firms in their portfolios.[14] However, the underlying motivation for banks to increase their shareholdings in non-financial businesses seems to have been capital gains rather than management control of influence. In fact, a bank's equity share is hardly a threat of potential control power as it is quite low compared to other shareholders. Furthermore, a bank's control of firms as a shareholder was severely limited due to regulations mandating "shadow voting," an obligation for financial intermediaries to vote with the management which is also the major shareholder. Therefore, we might say that Korean commercial banks generally had not been in a position to play a leading role in corporate governance matters.

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[13] Until now, financial institutions in Korea have not adopted mark-to-market accounting for securities, though it is in common use internationally and even in use by domestic corporations.

[14] For nation-wide commercial banks, the ratio of stocks relative to total assets of on-balance sheet accounts rose from 1.8% in 1989 to 3.3% in 1994 when the stock market was quite bullish, but declined to 2.1% in 1997. For the trust account, the ratio, which is carried off-balance sheet, decreased continuously from 9.1% to 3.2% during the same period (Table VII-7).

<Table VII-7> Nationwide Commercial Banks' Stock Holdings

(%, of total assets, year-end)

	1989	1990	1991	1992	1993	1994	1995	1996	1997
On-balance sheet account	1.8	1.6.	1.6	1.8	2.3	3.3	3.2	2.8	2.1
Trust account	9.1	8.8	6.5	5.2	4.7	5.6	4.7	3.7	3.2

< NBFIs >

98. Unlike banks, NBFIs were free of ownership restrictions except life insurance companies and investment trust companies.[15] As a result, many NBFIs are currently owned or actually controlled by *chaebols* (Table VII-8). As of 1997, the 70 largest *chaebols* owned a total of 109 financial affiliates – an average of five financial affiliates in the case of the 5 largest *chaebols* -- concentrated in securities companies, MBCs, non-life insurance firms, and installment credit companies.

99. The close links between NBFIs and *chaebols* have created scope for conflicts of interest. In fact, it appears that the *chaebols* have been using their affiliated NBFIs to finance the activities of 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, exercise of control of other firms via stock holdings, and other forms of unfair inter-group transactions. For example, *chaebols* have been using their affiliated MBCs, especially their overseas branches, and to a lesser extent their insurance companies, to finance the activities of other subsidiaries within their groups. In this situation, it is hard to expect prudent corporate monitoring by NBFIs.

100. 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

[15] For life-insurance companies, the 5 largest conglomerates were prohibited from newly entering the market and the 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 the 5 largest conglomerates wishing to enter the market should acquire 1-2 unsound institutions. For investment trust companies, the 30 largest conglomerates cannot own more than 15% (30% for local trust companies).

within the MOFE, making an effective monitoring almost impossible. *In short, the NBFIs have been under the strong influence of chaebols while government supervision was almost absent.* Such a 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.

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

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

	Top 5 *Chaebols*	Top 6-30 *Chaebols*	Top 31-70 *Chaebols*	Non-*Chaebols*
Merchant Bank (29)[2)]				
Securities (26)	3	7	4	14
Investment Trust	6	5	1	12
Company(14)	2	2	1	5
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	1	5	12	18
(219)	3	4	6	13
Venture Investment (56)	3	1	0	4
Card (7)	3	4	5	12
Finance & Factoring (46)				
Total (477)[3)]	27	42	40	109

Note: 1) The rank of *chaebol* is based on total borrowings.
2) The figure in parentheses represents the total number of financial institutions at each financial sector.
3) Leasing companies (a total of 39) are excluded because they are owned by banks.
Source: National Information and Credit Evaluation Inc.

3. Policy Responses to the Crisis: Financial Sector Governance System

101. Establishment of market principles, thereby preventing moral hazard problems, and enhancement of accountability and transparency of management are essential to improve the poor financial sector governance system. As of the end of September 1998, the first round of financial sector restructuring has been completed, and since the onset of financial crisis, various measures have been undertaken to improve both the financial sector's internal and external governance structure. Although not complete, it is quite a dramatic advance considering the pre-crisis situation.

< Internal governance structure>

- Rules for bank ownership were eased for investors to acquire strategic stakes in financial institutions. As large owners reach the thresholds of 10%, 25% and 33% of total equity, they will be subject to increasingly strong review by the Financial Supervisory Commission (FSC). It is expected that, in addition to injections of capital, foreign banks and investors can provide monitoring and managerial skills, and will apply international profitability standards.

- Since January 1998 under the Act Concerning the Structural Improvement of the Financial Industry, the supervisory authority is able to order the write off equities of shareholders deemed to bear responsibility for the insolvency of banks which the government has recapitalized or decided to recapitalize.

- In February 1998, in order to activate the function of shareholders and internal auditors in monitoring management status, the requirement conditions for the exercise of minority shareholders' right to initiate a class action were eased.

- The FSC has established and executed an efficient sanction system in which the FSC, if necessary, can impose civil and criminal liabilities on the directors. Also, the FSC can impose a claim for financial damage of financial institutions on the executives and employees having responsibilities for the insolvency and can impose the equivalent sanction on the external auditor and examiners of supervisory authorities for neglect of duties.

<External governance structure>

- Closure of insolvent financial institutions opened a new chapter in Korea's financial history, where no single commercial bank had been closed before. As of September 1998, five banks, sixteen MBCs, two securities companies and one investment trust company were permanently closed. In addition, four securities companies, four insurance companies and one investment trust company were suspended. If mutual savings and finance companies and credit unions are included, the total number of financial institutions either closed or suspended is 94. Another 115 financial institutions are currently pursuing mandatory restructuring by the order of FSC.

<Table VII-9> Financial Institutions Suspended or Closed

(As of September, 1998)

	Total No.of Institutions (end-1997)			
		License Revoked	Suspended	Subtotal
Banks	33	5	-	5
Merchant Banks	30	16	-	16
Securities Companies	34	2	4	6
Insurance Companies	50	-	4	4
Investment Trust Companies	8	1	1	2
Mutual Savings and Finance Companies	230	1	21	22
Credit Unions	1,653	12[1)]	27	39
Leasing Companies	25	-	-	-
Total	2,063	32	62	94

Note: 1) bankruptcy.

- A prompt corrective action system and management evaluation system have been introduced. A three-step corrective measure, composed of management improvement recommendations, management improvement measures and management improvement orders, will be imposed on the unsound financial institutions according to the degree of their unsoundness. To this end, the capital adequacy standards for deciding whether financial institutions are sound have been simplified.[16]

- To strengthen bank disclosure system, in April 1998, the FSC has increased the regular disclosure items to the scope requested by the IAS, to include, for example, asset classification, off-balance sheet transactions including derivatives, and special disclosure items such as those related to financial mishaps. Also, the FSC has increased the frequency of regular disclosure from once a year to twice a year.

- To upgrade prudential regulation standards, loan classification standards as well as

[16] These standards are the BIS capital adequacy ratio for banks and MBCs, the operational net capital ratio to the securities companies and payment capacity insufficiency ratio to the insurance companies.

provisioning requirements were strengthened in accordance with international practices in July 1998. Under the new classification standards, loans overdue for 3 months or more are categorized as "substandard" loans and those in arrears for 1-3 months as "precautionary" loans. Forward-looking asset quality classification standards well also be introduced in 1999. The required provisioning rate for "precautionary" loans was raised from 1% to 2%. Commercial papers, guaranteed bills and privately placed bonds in trust accounts have been included in the asset category subject to loan loss provisions and, the requirement of 100% of loan loss provisions for trust accounts with guarantees of principals has been added to those with guarantees of interests. 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.

4. Corporate Financing Patterns and Performance in Recent Years

102. As discussed before, the absence of well-developed equity markets, the provision of subsidized credits coupled with weak corporate governance have altogether resulted in *chaebols*' excess leverage without due consideration to default risk. By the end of 1997, the debt/equity ratio of the 30 largest *chaebols* reached 519% (Table VII-10). More surprising was that such extremely high debt/equity ratios have prevailed for several years before the crisis. For example, in 1995, the debt/equity ratios of several *chaebols* were already at unimaginable levels: Hanbo Steel Co. (675%), New Core Group (924%), Hanil Group (836%), Jinro Group (2,441%), Halla Group (2,855%), and Sammi Group (3,245%). During the period of 1997-98, all of them either went bankrupt or were subject to legal procedures related to composition or reorganization.

103. An important observation can be made from this example. Clearly, many *chaebols* have shown signs of rapidly deteriorating financial health and remained vulnerable to unfavorable cyclical shocks, such as the terms of trade shock 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. At this juncture, key questions are: 1) how could *chaebols* borrow to the point of unthinkable leverage in the first place, and 2) how could they survive for several years with such heavy burden of debt at the time of economic downturn? Answers to both of these questions critically hinge upon poor internal governance of both the corporate and financial sectors, as well as lax financial supervision.

<Table VII- 10> Top 30 *Chaebols*' Debt/Equity Ratios

(Unit: %)

1995		1996		1997	
Chaebols	Debt/equity ratio	*Chaebols*	Debt/equity ratio	*Chaebols*	Debt/equity ratio
1. Hyundai	376.4	1. Hyundai	436.7	1. Hyundai	578.7
2. Samsung	205.8	2. Samsung	267.2	2. Samsung	370.9
3. LG	312.8	3. LG	346.5	3. Daewoo	472.0
4. Daewoo	336.5	4. Daewoo	337.5	4. LG	505.8
5. Sunkyung	343.3	5. Sunkyung	383.6	5. SK	468.0
6. Ssangyong	297.7	6. Ssangyong	409.4	6. Hanjin	907.8
7. Hanjin	621.7	7. Hanjin	556.6	7. Ssangyong	399.7
8. Kia	416.7	8. Kia	516.9	8. Hanwha	1,214.7
9. Hanwha	620.4	9. Hanwha	751.4	9. Kumho	944.1
10. Lotte	175.5	10. Lotte	192.1	10. DongAh	359.9
11. Kumho	464.4	11. Kumho	477.6	11. Lotte	216.5
12. Doosan	622.1	12. Halla	2,065.7	12. Halla	-1,600.4
13. Daelim	385.1	13. DongAh	354.7	13. Daelim	513.6
14. Hanbo	674.9	14. Doosan	688.2	14. Doosan	590.3
15. DongAh Construction	321.5	15. Daelim	423.2	15. Hansol	399.9
16. Halla	2,855.3	16. Hansol	292.0	16. Hyosung	465.1
17. Hyosung	315.1	17. Hyosung	370.0	17. Kohab	472.1
18. Dongkuk Steel	190.2	18. Dongkuk Steel	218.5	18. Kolon	433.5
19. Jinro	2,441.2	19. Jinro	3,764.6	19.Dongkuk Steel	323.8
20. Kolon	328.1	20. Kolon	317.8	10. Dongbu	338.4
21. Tongyang	278.8	21. Kohab	590.5	21. Anam	1,498.5
22. Hansol	313.3	22. Dongbu	261.8	22. Jinro	-893.5
23. Dongbu	328.3	23. Tongyang	307.8	23. Tongyang	404.3
24. Kohab	572.0	24. Haitai	658.5	24. Haitai	1,501.3
25. Haitai	506.1	25. New Core	1,225.6	25. Shinho	676.8
26. Sammi	3,244.6	26. Anam	478.5	26. Daesang	647.9
27. Hanil	936.2	27. Hanil	576.8	27. New Core	1,784.1
28. Kukdong Construction	471.2	28. Keopyong	347.6	28. Keopyong	438.1
29. New Core	924.0	29. Miwon	416.9	29. Kangwon Industrial	375.0
30. Byucksan	486.0	30. Shinho	490.9	30. Saehan	419.3
Total	347.5		386.5		519.0

Source : Fair Trade Commission.

104. As a basis for discussions on the relationship between the issue of corporate governance and financial soundness and performance of firms, it would be desirable to document the financial landscape of the corporate sector, particularly *chaebols*, in greater detail. Given the high debt leverage of the corporate sector, a large share of operating earnings went to servicing their debts. Chart VII-2 shows the trend of the interest payment coverage ratio, calculated as operating earnings over interest expenses, of the listed companies during the period of 1986 and 1998. Operating earnings used in this paper are EBITDA (Earnings Before Interest payment and Taxes plus Depreciation and Amortization). Therefore, those firms whose interest payment coverage ratio is below 1 are likely to go bankrupt. The total

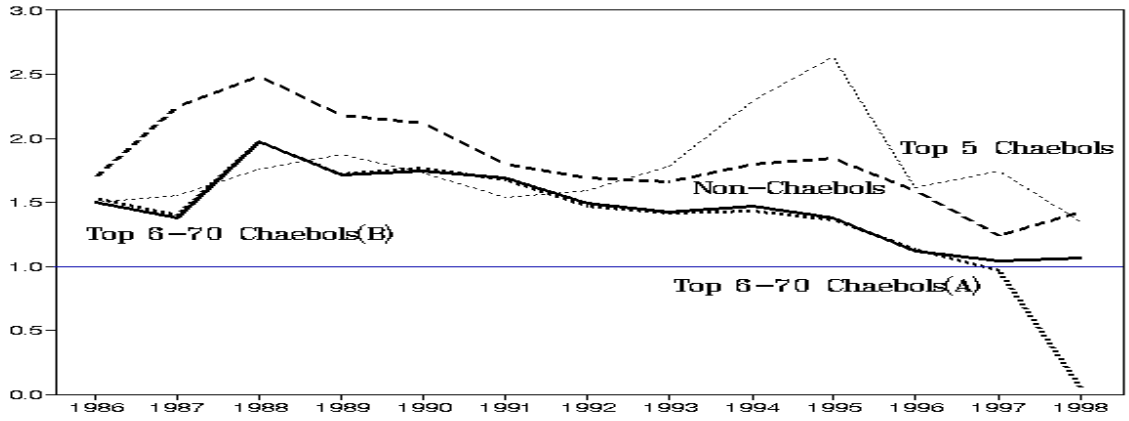
number of listed companies covered by the sample is 504, and these companies are classified into two categories: *chaebol* affiliates and non-*chaebol* independent companies. At the end of the first half of 1998, the top 6-70 *chaebols*' interest payment coverage ratio (weighted average) was merely 0.04 (1.06, if Kia and Asia automobile companies are excluded), far below the level of the top 5 *chaebols* (1.35) and non-*chaebol* independent companies (1.42).

105. Such financial vulnerability of the top 6-70 *chaebols* has been attributed to weak business performance and high leverage. By the end of the first half of 1998, the top 6-70 *chaebols*' business performance, calculated as the EBITDA over total assets, sharply deteriorated while their financial leverages continued to rise. Consequently, the top 6-70 *chaebols*' net profits to total assets plunged to -9.9% (-1.2%, if Kia and Asia automobile are excluded) from -1.8% in 1997 (-1.3%, if Kia and Asia automobile are excluded). Unfortunately, both poor business performance and high debt leverage are not recent phenomena as these conditions have been present since the mid-1990s.

106. For the top 5 *chaebols*, by the end of the first half of 1998 the operating earnings have increased, apparently due to sharp reduction in wage costs and robust exports. Despite the increased earnings, however, they have also experienced difficulty in servicing debt as their debt continued to grow. As a result, the top 5 *chaebols*' net profit rate fell to -0.4% in the first half of this year from -0.1% in 1997. In contrast, non-*chaebol* independent corporations showed visible improvement during the first half of 1998 with substantial progress in restructuring. Their interest payment coverage ratios have risen due to a combined effect of debt reduction and increased earnings. Consequently, their net profit rates turned positive, 0.4%, in the first half of 1998.

<Chart VII-2> Interest Payment Coverage Ratios for Listed Firms

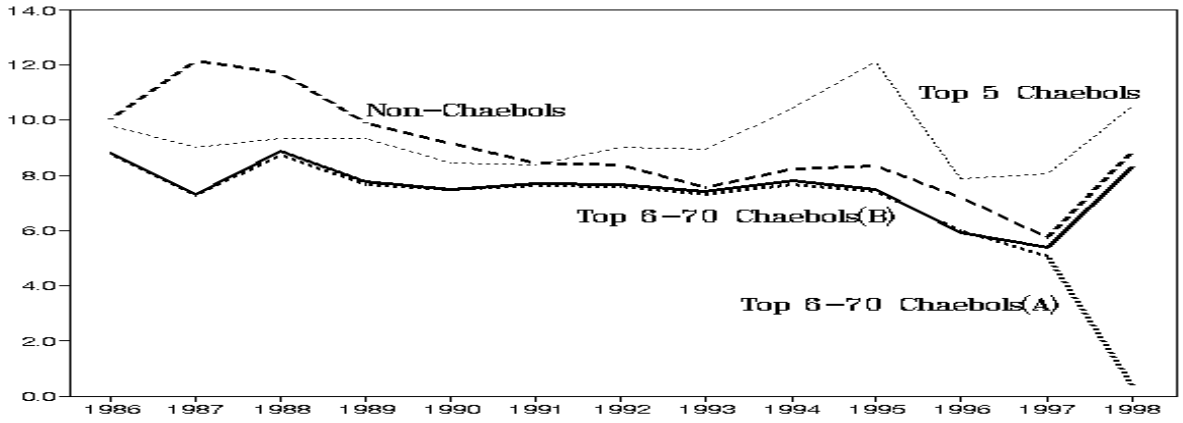
(Unit: times)



Note: 1) Figures for 1998 are those for the first half of 1998.
2) (A) includes all subsidiaries of the top 6-70 *chaebols*, (B) excludes Kia and Asia automobile companies among the top 6-70 *chaebols*
Data Source: National Information and Credit Evaluation Inc.

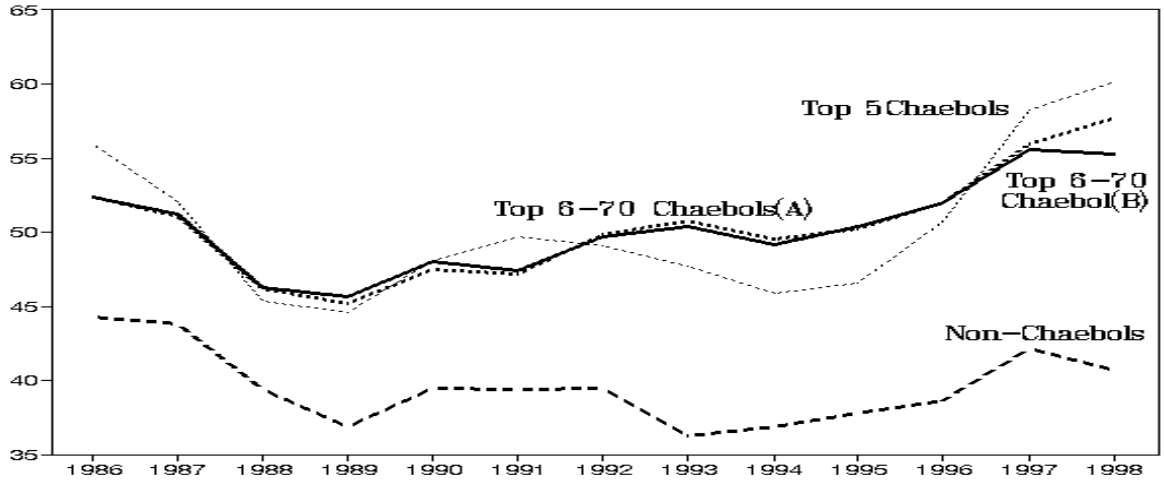
<Chart VII-3> EBITDA/Total Assets for Listed Firms

(Unit: %)



Note: 1) Figures for 1998 are those for the first half of 1998.
2) (A) includes all subsidiaries of the top 6-70 *chaebols*, (B) excludes Kia and Asia automobile companies among the top 6-70 *chaebols*
Data Source: National Information and Credit Evaluation Inc.

<Chart VII-4>Total Borrowings to Total Assets for Listed Firms
(Unit: %)

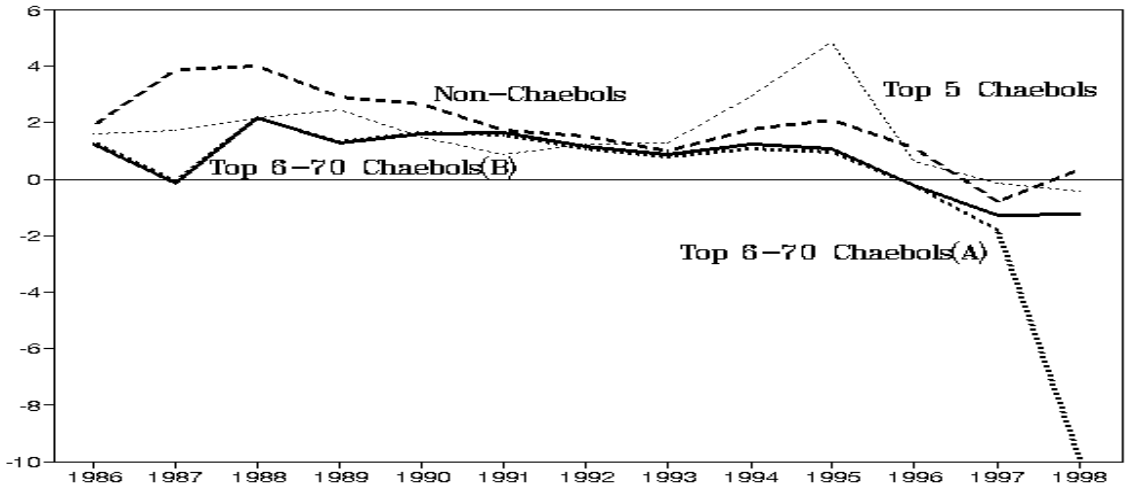


Note: 1) Figures for 1998 are those for the first half of 1998.
2) (A) includes all subsidiaries of the top 6-70 *chaebols*, (B) excludes Kia and Asia automobile companies among the top 6-70 *chaebols*

Data Source: National Information and Credit Evaluation Inc.

<Chart VII-5> Net Income to Total Assets for Listed Firms

(Unit: %)



Note: 1) Figures for 1998 are those for the first half of 1998.
2) (A) includes all subsidiaries of the top 6-70 *chaebols*, (B) excludes Kia and Asia automobile companies among the top 6-70 *chaebols*

Data Source: National Information and Credit Evaluation Inc.

107. Table V-11 also shows the significance of financial trouble in the corporate sector before and after the financial crisis in terms of the interest coverage ratios. In 1995, when the Korean economy was in a boom cycle, there already existed signs of financial weakness to some degree in both corporate performance and financial structure: the number of firms with interest payment coverage ratio below 1 was already 61, which amounts to 11% of total listed firms. This number increased to 158 (31% of total listed firms) in the first half of 1998, which is 2.6 times as high as the figures in 1995, largely due to a drastic rise in interest rates and sharp reduction in profitability since the onset of financial crisis. The situation is particularly pressing for the top 6-70 *chaebols*.

<Table VII-11> Deteriorating Corporate Performance

		Interest Payment Coverage Ratio							
		1995		1996		1997		1998	
		≥ 1	< 1	≥ 1	< 1	≥ 1	< 1	≥ 1	< 1
Top 5 *Chaebols*	Number Of firms	56	4 (7%)	52	8 (13%)	52	9 (15%)	46	14 (23%)
Top 6~70 *Chaebols*	Number Of firms	127	15 (11%)	114	28 (20%)	96	46 (32%)	67	58 (46%)
Non-*Chaebols*	Number Of firms	288	42 (13%)	288	61 (18%)	279	87 (24%)	233	86 (27%)
Total	Number Of firms	497	61 (11%)	454	97 (18%)	427	142 (25%)	346	158 (31%)

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

108. 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. Such reductions in factor costs are significantly improving firms' balance sheets and lowering interest coverage ratios. These developments will contribute to the reduction of the corporate default risk. Nonetheless, considering the heavy debt service burden of *chaebols* and the weak domestic demand, the potential of large business failures cannot be ruled out. Unless debt reduction measures, including debt-equity swaps, are carried out upfront, debt overhang would persist and the process of rehabilitation of troubled firms would be delayed.

Part VIII. Insolvency Mechanisms

109. There are usually two types of formal insolvency procedure in a corporate insolvency law

regime. One is *liquidation* (or winding-up) in which the commercial activities of an insolvent firm are terminated and its assets are sold either on a piece-meal basis or as a whole. In Korea, the Bankruptcy Act administers liquidation procedure. The other is *reorganization* (or rescue) which provides for the continuation of an insolvent corporate debtor with restructuring of the financial claims of its creditors and shareholders, and entails a change in the management and the ownership structure. The Company Reorganization Act and the Composition Act provide for reorganization procedure in Korea.

110. *Informal workouts* can be used as an alternative to the formal procedures of the insolvency law regime when the debtor firm and its creditors would prefer to conduct negotiation of rescheduling or restructuring with more flexibility. They can be less costly and speedier than the formal procedures which involve the courts. Other than informal rescheduling of loans between a debtor firm and its banks, an informal workout program has recently been introduced since the economic crisis by the Corporate Restructuring Agreement among the financial institutions in Korea.

111. *M&A markets* can play the role of an insolvency mechanism in that an insolvent firm can be bought by private investors, or be acquired by or merged into another firm, and the financial claims are repaid or rearranged in the process. However, the *M&A market* has played only a minimal role as an insolvency mechanism in Korea since it has almost been non-existent due to the concentrated ownership structure and the regulations in the stock market.

<Formal Insolvency Procedures>

112. The liquidation procedure under the Bankruptcy Act may be initiated by the insolvent debtor, creditors or other interested parties. Once the application is filed and accepted, the court may issue an order to preserve the debtor's assets. Then a bankruptcy administrator is appointed to oversee the process, which will eventually distribute the remaining assets to the creditors in an equitable manner.

113. The reorganization procedure under the Company Reorganization Act may be initiated by the debtor firm, its creditors or shareholders. Once a petition is filed, a temporary order to preserve the debtor firm's assets may be issued. Only when the petition is accepted by the court, the formal proceeding is commenced. The most important criterion for acceptance is whether the firm's going-concerns value is greater than its liquidation value. Once the formal proceeding is under way, a receiver is appointed by the court; investigation of the firm's assets and debts is conducted by the receiver; and meetings of creditors and

shareholders are convened. A reorganization plan is prepared[17] and, once confirmed, can change the financial and ownership structure of the debtor firm. The receiver plays a central role since he/she not only oversees the process but also makes all the important decisions on the firm's operation with the court's approval.

114. The Composition procedure is similar to that of the Corporate Reorganization Act, except a few important differences. First, the Composition procedure can by initiated only by the debtor firm, and its management is still in charge of its operation during the process. Second, a composition plan is proposed solely by the debtor firm, whereas the receiver, its creditors and shareholders can also propose a reorganization plan under the Company Reorganization Act. Third, the composition plan can only reschedule or modify the terms of the existing unsecured debts.

115. These formal insolvency procedures were not used very often in Korea until the crisis drove many of the highly-indebted firms into deep financial trouble or bankruptcy, as shown in Table VIII-1 and Table VIII-2 for cases under the Bankruptcy Act and the Company Reorganization Act, respectively. The composition has been used even less often. For the first 34 years since the Act was introduced in 1962, there were only 26 petitions (2 cases in 1985, 2 in 1989, 13 in 1995, and 9 in 1996). But 322 firms filed for the Composition procedure in 1997.

<Table VIII-1> The number of cases under the Bankruptcy Act

Year	1990	1991	1992	1993	1994	1995	1996	1997	98.1~6
# of cases	27	16	17	26	18	12	18	38	201

Source: Court Administration Agency

<Table VIII-2 > The number of cases under the Corporate Reorganization Act

Year	1990	1991	1992	1993	1994	1995	1996	1997	98.1~8
# of cases	15	64	89	45	68	79	52	132	24[18]

Source: Court Administration Agency

116. In addition, the formal procedures have not been very effective in restructuring and rehabilitating debtor firms in trouble. For example, under the reorganization procedure only slightly over 20% of the firms which had filed emerged successfully out of the process in

[17] A reorganization plan can be proposed by the receiver, creditors, shareholders, and the debtor firm under the Company Reorganization Act. In practice, however, it is usually prepared by the receiver.

recent years.

<Table VIII-3> Period of Time between Commencement and Conclusion/termination and the Number of Cases (1993-95)

	Within 3 yrs	4-5 yrs	6-7 yrs	8-10 yrs	11-15 yrs	16-20 yrs	Total
Successful turnaround, conclusion	1	1	2	6	7	1	18
Failure, termination	17	12	10	8	5	0	52

Source: Court Administration Agency

117. There can be found a few reasons for the under-utilization and ineffectiveness of the formal insolvency procedures in Korea.

- First, it is often pointed out that the formal proceedings under the court tend to be time-consuming and expensive. This has to do with the level of development of legal infrastructure in general, and the lack of expertise and professional assistance within the court in particular since a separate bankruptcy court did not exist.

- Second, sometimes the rules were not specific or thought out enough that they left room for much discretion by judges and for abuse by debtor firms. For example, under the old Company Reorganization Act before the 1998 amendment, the criteria for proceeding commencement included the possibility of firm's rehabilitation and the public interests. These rules were often used in favor of debtor firms for the protection of reorganization proceeding at the expense of the creditors' interests. For another example, a change in the Company Reorganization Act in early 1998 made mandatory the wipeout of half of the existing shares if the firm is insolvent. Then the rest of 1998 saw a sharp rise in the number of cases of the Composition procedure in which the management of the debtor firm is intact and such mandatory wipeout is not applied. This came about as many controlling shareholders of failing firms scrambled to preserve their interests, *regardless of* whether their firms' situation was suitable for the composition process or not.

- Third, the heavy dependence on bank loans for corporate financing and the relationship-based system set in motion a vicious circle for the insolvency law

[18] The number cases filed at the Seoul District Court.

regime. With a huge stake in each other through the large amount of debt, both banks and a troubled firm have incentives to reschedule the firm's debt without going through the court procedure, especially when they are closely tied up by government policy such as the main bank system. Also the government often bypassed the formal procedure by bailing out the large corporations which followed its industrial policy in Korea during the 1970s and 1980s. As a result, the insolvency laws and the court system were not given sufficient opportunity to develop themselves as the economy's size and complexity grew. This in turn hampered development of the securities market for debentures or corporate bonds because potential investors in the market were not confident that their claims would be properly repaid in case of bankruptcy, and many chose to stay out. It reinforced most firms' reliance on loans from banks and other financial institutions.

<Informal Workout>

118. The Corporate Restructuring Agreement was signed by all the financial institutions in Korea in 1998 as an attempt to prevent a systemic corporate bankruptcy in the aftermath of the economic crisis and to facilitate an economic recovery. The process can be initiated by the consent of the lending financial institution of a debtor firm. After due diligence, the main bank proposes a debt restructuring plan. If the creditors representing more than 75% of the firm's debt vote for the plan, it becomes binding all the institutions. If the creditors cannot reach an agreement after two attempts, the case is referred to the Corporate Restructuring Committee whose decision becomes binding.

119. Currently 79 firms are undergoing debt restructuring under the Corporate Restructuring Agreement, while 63 of them now have their restructuring plan confirmed.[19] The total amount of their borrowing from the credit institutions is estimated at 13 trillion won. Even though there are variations, most restructuring plans features the following elements: about 10% of unsecured credit to be converted into equity or convertible bonds; a combination of repayment extension, interest exemption and interest reduction for the rest of unsecured credit; and retention of the current controlling shareholders and management on conditions of asset sales or additional capital inflow.[20] It should be noted that a super-majority voting in the shareholders' meeting is required for the debt-equity conversion to be actually executed, since the Corporate Restructuring Agreement is a contract among the financial institutions and, consequently, in itself does not bind the shareholders of the debtor firm.

120. To the extent that a systemic bankruptcy of corporate sector should be avoided and that the

[19] Three cases (Tong-il group, Kyung-ki Chemical, and Anam Electronics) were failed under the agreement, and all three firms filed for the Company Reorganization procedure.

[20] There have been only three cases where the current controlling shareholders or management were stripped of their control of their firm: Dong-A Construction, Keo-pyung, and Dong-Kook Trading.

existing formal insolvency procedures are not well developed and efficient enough, the Agreement can be thought of as an appropriate response by the financial institutions and the government. In this context, three main tasks to be addressed by the procedure can be identified: 1) preventing bankruptcy of economically viable, though heavily indebted, firms, 2) preventing banks and other financial institutions from being unfairly expropriated to "save" the corporate sector, and 3) disciplining the incompetent management and reckless controlling shareholders.

121. However, there are several obstacles: 1) the lack of experience and commercial knowledge among the bank personnel who are involved in the process; 2) the reluctance to supply new money to the debtor firm on the part of financial institutions other than the main bank; 3) the ineffectiveness of the formal procedure as a threat to the creditors and the debtor firm in case of failure of the informal one; 4) the lack of effective corporate governance within the institutional creditors such as banks could fail to provide strong enough incentives for the bank employees to actively strive for a successful workout. Especially given the nature of the Corporate Restructuring Agreement as a private contract, the last two obstacles may give the current controlling shareholders of debtor firm some incentive to hold out in the hope of exacting a bigger concession from the creditors.

122. One important instrument to make a successful workout is the judicious use of debt-equity conversion. It can relieve the debtor firm from the immediate pressure of debt service, reward the creditors with a rising stock price if the conversion price has been set properly, and perform a disciplinary function with the change in ownership structure and in management. Most of the workout programs approved so far under the Corporate Restructuring Agreement contain a debt-equity conversion provision. One curious feature in many of the cases, though, is that the incumbent management or controlling shareholders remain in control even after their shares have been almost wiped out. It is not clear whether this reflects the competence of the incumbents, the perverse incentives problem as mentioned above, or the aversion of the banks to exercise control over their client firm, which may have something to do with the lack of effective corporate governance in the banks.

<Recent Developments>

123. The Korean government had begun the amendment project of bankruptcy-related statutes in 1996, which was concluded in early 1998. (1998 amendments to the Company Reorganization Act and the Composition Act) The following are important elements in the 1998 amendment.

- Economic Test: Instead of possibility of rehabilitation and public interests, an

economic test was adopted as a criterion for the commencement of reorganization process which compares the liquidated value of company's assets and the going-concern value of a reorganized company.

- Administrative Committee: An administrative committee is established to provide courts administrative service and experts' advise. It is composed of accountants and lawyers who have experience in corporate reorganization.

- Time Limitation: To expedite a reorganization process, time limitations are stipulated: a reorganization plan should be submitted within 4 months after the filing of a petition; the vote on a reorganization plan within a year from the commencement of reorganization proceedings (extensible up to 6 months in case of unavoidable causes); a provisional order of stay within 14 days after the filing of a petition, the order of a commencement of a composition proceeding within 3 months from the filing of a petition(extensible up to 1 month). The duration of restructuring in a reorganization plan is limited to 10 years.[21]

- Amortization of Shares and Mandatory Assessment: A 1996 Supreme Court Rule provided that the court should amortize shares which were owned by majority shareholders who were in charge of management. The rule was criticized because of the lack of statutory foundation. The 1998 amendment enumerates that more than half of stocks should be amortized in case that debts exceed assets, and more than two thirds of stocks which are owned by dominating shareholders who are liable for bankruptcy. Assessment is a summary procedure to examine the liability of directors and auditors for bankruptcy and order them to pay damages. It was stipulated in the 1996 Rule, but never applied. The 1998 amendment adopts the assessment provision to induce a sound practice in management.

- Creditors' Conference: Creditors had complained that enough information was not given to them both before and after the commencement of a reorganization process. Creditors' Conference is organized as an information channel to creditors from the receiver and the company. It is also expected to function as a forum among creditors.

124. Currently, a new set of amendments to those statutes are under public review after the final draft was completed in February of 1999. The 1999 Amendment Draft (the Draft) is a response to the criticism that reorganization proceedings in Korea are still slow and inefficient. The order of commencement of a reorganization proceeding is rendered at least after five months from a filing and there is no time limit from a filing to the order of

[21] However, these limitations tend to be interpreted not as mandatory provisions but as recommended ones by the judges

commencement. Company's financial status is examined twice: by an investigative committee before the order of commencement and by the receiver after the order.

- The Draft provides that the order of commencement of a proceeding should be within a month after a filing. It means that the courts should decide the commencement according to formal requirements without reviewing the possibility of rehabilitation or comparing liquidation and reorganization value. Following the order of commencement, a receiver examines the company's financial statues with or without the help of an investigative committee.

- The Draft allows an easy and quick commencement of rehabilitation procedures on the one hand, but it adds a restriction on the other. When the process is repealed or the reorganization/composition plan is rejected, the courts should adjudge the debtor company to be bankrupt.

- The voting requirement for confirmation of reorganization plan has been reduced from 3/4 to 2/3 for secured creditors whose credit repayment is to be extended, and from 4/5 to 3/4 for those secured creditors whose interests are to be impaired in other ways than repayment extension.

Part IX. Transparency and Disclosure

125. The lack of transparency and inadequate disclosure have been recognized to be an important contributing factor in the failure of corporate governance in Korea, to the extent that the periodical financial statements and public disclosure in the securities market are the major source of corporate information for outside shareholders and other investors and the means to protect their interests.

126. One major problem area has been the failure of financial statements to accurately represent a firm's operating activities and financial health. According to the Security and Futures Commission (SFC), for example, 36 out of the 122 listed companies whose financial statements were reviewed by the SFC were found to have violated the accounting rules for 55 cases in 1997, up from 15 companies for 42 cases in 1996. This figure amounted to roughly 1 out of 3 listed companies being in violation with respect to their financial statements. For another, 66 CPAs were subject to disciplinary action for inadequate audit of financial statements of listed and public companies in 1998, up 25% from 53 in 1997.

127. There can be identified several factors. First, the lack of effective governance within a firm has allowed the controlling shareholders and incumbent management to tamper with the firm's financial data to their advantages. Second, the current system for independent auditing has failed to establish the independence of outside auditors from the incumbent management. Since the outside auditors must compete with others for their business with a firm, they are susceptible of the pressure to cater to the needs or demands of the controlling shareholders. Third, the government has often changed the financial accounting rules for the purpose of making the firms' financial statements "look better" than their actual conditions.[22] Last but not least, the government has been passive in enforcing the accounting and disclosure rules and in punishing violators.

128. In recent months, the government has introduced significant changes in the financial accounting standards. The SFC and FSC approved amendments to the corporate accounting standard prepared by the Financial Accounting Standard Council (FASC) in December of 1998 with a view to making the Korean accounting standards conform more closely to the internationally accepted accounting principles including the U.S.'s. The major elements in the amendment are as follows:

- Loss/gain from foreign currency-denominated asset/liability due to foreign exchange fluctuation is now reported as a loss/gain on the current income statement, instead of deferred asset/liability on the balance sheet.

- Financial claims or liabilities are to be reported at present value reflecting changes in repayment schedule, interest rate, etc, for example, when the those claims/liabilities are subject to a reorganization or workout plan, and the corresponding loss/gain is to be reported on the current income statement. They used to be reported at book value even after the relevant contract terms are modified.

- It is now mandatory to apply the equity method to valuation of securities when they represent a significant control (usually 20% of equity). In the past, firms were given a choice between equity method and cost method.

- Derivatives are to be marked to market on the balance sheet as assets or liabilities, and loss/gain from their transactions is to be reported on the income statement. In the past, information on derivatives was only required to be provided in the footnotes.

- Bonds and debentures are to be marked to market on the balance sheet, and the corresponding loss/gain is to be reported. However, those that are certain to be held to their maturity are still to be valued according to cost method.

129. With respect to the dominance of the *chaebols* in the Korean economy and the actual and potential abuse of outside shareholders by the insiders, the government has established a separate Standards for the Combined Financial Statements for the 30 largest *chaebols* designated by the Fair Trade Commission (FTC). The major elements are as follows:

- The combined financial statements consists of combined balance sheet, combined income statement, and combined cash flow statements. The statement of changes in equity is disclosed in a footnote.

- The combined financial statements are prepared under the assumption that *chaebol* affiliates under the common control constitute a single economic entity. Therefore intragroup balances, intragroup transactions, and resulting unrealized profits and losses are eliminated in preparation of the combined financial statements, unless they are immaterial. The principle of 'substance over form' is used in identifying intragroup transactions.

- The Standards require footnote disclosure of intragroup transactions, including intragroup ownership interests, cross guarantees, cross pledging, intragroup borrowings, intragroup sales. Especially, information useful for estimating the overall risk of a given *chaebol* is provided in a matrix form showing relevant parties and

[22] The latest example was the change in the accounting standards in late 1997 for losses in foreign currency-denominated debt due to exchange rate fluctuation.

amounts of intragroup transactions.

- The Standards for the Combined Financial Statements become operative for fiscal years beginning on or after January 1, 1999.

130. The government has also strengthened the penalties for auditors and management in violation of the 'Independent Audit Act'. An auditor who receives or demands monetary rewards in return for a wrongful request can be punished by a jail term of up to 3 years, or by fines of up to 5 times the relevant economic gains from the audit. In the past, the limit was 3 years or 20 million won. The management or an employee in charge of accounting can be punished for failing to prepare financial statements and for preparing them in violation of the accounting standards by a jail term of up to 2 years or by fines of up to 20 million won, up from 1 year or 5 million won.

131. Another major area for improvement is disclosure in the securities market. Listed companies in the Korea Stock Exchange (KSE) are required to submit specific periodic reports to the FSC and the KSE, and to disclose necessary corporate information through the KSE in three major categories.

- Disclosure in the primary market includes the registration statement which should be filed with the FSC and the prospectus which should be provided to investors before the issue. The issuer also has to file with the FSC a report of public offering results.

- Disclosure in the secondary market includes periodic disclosure in the form of annual and semi-annual reports (the annual report must be accompanied by a CPA's audit opinion),[23] and ongoing disclosure of material information which may have a bearing on the company's future performance or its asset value.

- Special disclosures cover tender offer, merger, divestiture, stock repurchase and sale of company's own shares, acquisition of block shares (5% rule), share ownership of directors and majority shareholders, and proxy solicitation.

132. These formal rules of disclosure have been developed over time, so that they conform more or less to the international standards *in form*. However, it is widely recognized that the *quality and substance* of disclosure leave a lot to be desired, especially from the investors' viewpoint. The financial statements often did not accurately represent a company's business and financial health, and important corporate information was sometimes not disclosed in time and in full, or not at all. The problem largely stems from three factors: (a)

[23] If a company has an affiliate, consolidated financial statements must also be submitted with a CPA's audit opinion.

the corporate insiders did not feel the pressure or need for more adequate disclosure because of the lack of effective governance within and market discipline without; (b) the outside shareholders and investors did not have effective means to redress damages due to inadequate disclosure, since derivative lawsuit was not practically useful and class action lawsuit was not allowed; (c) the penalties for violation of disclose rules were mild,[24] and the regulatory authorities were not aggressive going after the violators.

133. Since the economic crisis highlighted the deficiencies in disclosure in the securities market, the government has introduced, or been in preparation of introducing, several improvements on disclosure system.[25]

- Quarterly report: From the year 2000, listed companies will be required to submit quarterly reports to the FSC and the KSE. The quarterly reports are not required to be subject to external audit.

- Combined Financial Statements: The 30 largest *chaebols* will be required to report combined financial statements starting from the fiscal year 1999, as described above.

- Electronic Filing System: The FSC is planning to introduce an electronic filing system in order to lessen the burden of companies to prepare and submit required reports and to make easier the access to corporate information by the general public. In the first stage, annual reports and audited financial statements are to be processed through the electronic system. A complete system processing all the required documents is expected to be launched in March, 2000.

- Class Action Lawsuit: The ruling party has recently proposed a bill to introduce the class action lawsuit in the securities market, specifically in the cases of untruthful registration statement and annual or semiannual reports, and untruthful tender offer statement.

- Severer Penalties: It is recently proposed that those who make an untruthful statement of, or omit, material fact be fined up to 1 billion won, up from the current 5 million won.

[24] Violation of periodic and ongoing disclosure requirements can be punished by fines up to 5 million won, for example. Also, in no case of violation can the violating company be punished by de-listing.

[25] This list is summarized from Choi and Woo (1998).

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