**Organisation for Economic Co-operation and Development**

**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"

**Yoon Youngmo**

**International Secretary**

**Korean Confederation of Trade Unions**

# *Chaebol Reform: the missing agenda in "corporate governance"*

***Seoul, 3-5 March 1999***

"Comparative perspective" is important not only to bring together the views and experiences of different countries, but also to inject the perspectives of different actors which have a role or stake in the issue. Whereas the 'comparative perspective' of different countries can reveal to us the different experiences, paths, and achievements and shortcomings found in different countries and approaches, 'comparative perspective' of different actors is vital in building the foundation of a successful outcome. That is why it is important to bring together the voices and perspectives of many diverse actors. This means that not only discussions about but the actual determination of the shape of corporate governance should not be limited just to the 'technical' or 'expert' practitioners, but the various political actors and social actors who are not only affected by the outcome but have a legitimate stake in the shaping of and in the validation of the outcome.[*]

***Why the Talk of Corporate Governance***

Why are we or should we be concerned about 'corporate governance'? Why should a government be concerned about 'corporate governance'? Why should a society be concerned about it. Shouldn't it be a matter for the business or the firms – and those people who are related to them?

Even if the matter of 'corporate governance' should be a matter of 'those people who are related to' the firms in question, workers have a natural right and responsibility to be concerned about it. Who would be more closely bound up with the issue that concerns the health of the companies than the workers whose livelihood is linked to them?

Corporate governance is an issue that is vital to the well-being and the welfare of not only the 'owners' and 'shareholders' of the companies, but the workers and the people in the society as a whole. This is well noted – but all of us need to be remind of this – as can be seen by the fact that some crucial facets of 'corporate governance' is governed by the laws enacted by the legislature representing the sovereign and democratic will of the people of the land.

Why 'corporate governance' is and should be a matter of concern of and for the people is demonstrated most amply and painfully by the crisis which has wreaked disastrous damage to the economy and the society – and the people.

The issue of 'corporate governance' in the context of the "currency, financial, economic crisis" in Korea – which has brought about a massive social crisis, as highlighted by the five-fold increase in unemployment – can only be understood in the context of the overall reform needs.

The issue of 'corporate governance' in Korea is a part of the agenda of reform of the *chaebol* structure and system. Furthermore, debates and efforts in this front cannot be complete or effective without a comprehensive 'attack' on the system which has sustained the malpractice of the *chaebol* system and structure. Without a reform of the system of corruption and 'insider' dealings which link the government and its various bureaucratic agencies and personnel, politicians, banks, and *chaebol* firms, all the talk of 'corporate governance' is meaningless.

Furthermore, the discussion and efforts for reform of the corporate governance cannot turn a blind eye to the global economic reality in which massive financial capital moves around the globe in

[*] This is a slightly revised version of the original paper presented at the conference. Prof. Kim Ki-won (Korea Open University) contributed to this paper through his careful documentation and analysis.

search for second by second or minute by minute transaction profit without any regard for long term development needs of a national economy.

A debate and effort on corporate governance which fails to address the issues of 'political' dimension and international financial capital, therefore, can only, at best, be temporary band-aid measure. Nevertheless, it is necessary to identify some issues specific to the 'corporate governance' agenda.

### *The Three Aspects of the* **Chaebol** *Reform Agenda*

- The internal structural reform – modernising task
- The external structural reform – dismantling the dictatorial monopoly over the national economy; confronting unfair competition and monopoly dominance
- The task of resolving 'over-investment'

1. Korean *chaebols* are characterised by dynastic control obtained and exercised by the chief owner. While 'owner-manager' system does not in itself spell 'bad', it has come to take on a totally different meaning from the early days, as *chaebols* have grown in size and scope, as they become actors in globalised environment, and as the 'power' of the founder-owner is passed down to their children.

*Chaebol* owner is different from the owner of an SME: a *chaebol* owner-chief exercises an unchallenged and unaccountable control over a network of companies whose total asset is 40 to 50 times the capital he has actually invested. This is not just a problem of the vast pool of minority shareholders who have had no say against the owner-chief (the controlling single largest shareholder). The *chaebol* owner-chiefs are in fact 'trustees' of the wealth and assets of the whole nation and her people. Therefore, the inability and corruption of a *chaebol* chief is not just a personal problem or a problem of the company in question, but the problem of all people.

Therefore, a *chaebol* firm must be endowed with structures and mechanisms of transparency, responsibility, accountability, and participation. The agenda of dismantling the dynastic control calls for employee participation in the management decision making process, expansion of employee shareholdership, outside members in the board of directors, and auditors-inspectors who represent the interest of the 'stakeholders'.

2. The dominance of *chaebol* firms has brought about a suffocated development of SMEs and a gross imbalance in the national economy. This was exasperated by the recent developments where the power of *chaebols* has surpassed the capacity of the government and banks, breaking out of their gravitational influence.

In the earlier period from the 1960s to mid-1980s, the *chaebol* firms were confined by an external governmental control within the government-banks-*chaebols* a network built up to meet the imperative of 'export-led development'. But, since the mid-1980s, the government was out-manoeuvred and out-paced in terms of capacity and will by the *chaebol* firms as the *chaebols* became more powerful with greater access to the opportunities that lay beyond the control of the government; and at the same time, the government – in the course of transition towards greater democracy -- failed to obtain or build new basis of legitimacy and regulatory regime with effective democratic procedural instruments. Banks – nurtured by state directives and sponsorship – also failed to meet the challenge posed by newly empowered *chaebols*.

The changed situation saw the rapid expansion and unchallenged consolidation of the *chaebols*. The commodity and capital 'markets' – for long shaped by protection and regulation mandated by the 'export-led development' network and consensus – were not in position to exercise a check on the *chaebols* out of control.

The combination of the one-man rule typical of *chaebol* structure and the absence of the mechanisms of control gave rise to irrational expansion, diversification, and over-stretching, on the one hand, and deep-rooted unfair competition, insider transaction, and corruption, on the other hand. The result is an economy and people held hostage by the *chaebols* – who are too big and explosive to be allowed to fall or die out of the system.

The dominance of the economy by the *chaebols* is dangerous for a nation and an economy. It has to be checked and a new healthy balance restored to the system. The 'internal' reform of the *chaebol* structure – removing the dynastic control: the ownership-governance-management matrix – lies at the heart of any effort to redress the whole problem. This will also pave the way for restoring the balance in the government-bank-firm relationship. [The government, in the changed configuration, cannot, however, base its role in relation to banks and firms on the military-dictatorial power aided bureaucratic-technocratic 'rationalism' as before, but on democratic and societal consensus, principles, and participatory process.]

3. The reform of *chaebol* system and structure must also address the problem of over-investment. This problem has arose from the internal logic of the *chaebol* system, spurred on by some of its defining characteristics – the pursuit of the 'profit of control', second generation complex [a syndrome created by the ambition of the children of the founder-chiefs – inheriting the total control – to demonstrate their 'worth'], moral hazard, competition for self-enlargement and self-aggrandisement.

The problem of 'natural' or 'cyclical' over-investment – accentuated by the capital-intensive activities – has taken on a colossal dimension as *chaebols* have become dinosaur monopolies with a will and power to hold the entire system as a hostage for their own survival.

Any problem of over-investment is informed by over-capacity and declining rate of profit. Efforts to respond to the problem of over-capacity brings the size of facility and workforce into the focus, while declining rate of profit may require value destruction, such as, below-the-rate sale of the firms or debt forgiveness. Any of these efforts naturally gives rise to tension and conflict amongst firms, banks, workers, shareholders, and citizens – each of them endeavouring to minimise the loss that may be incurred in the process. The question is how the 'burden' is to be shared.

**The Outcome – no progress**

The Korean government's efforts – propelled by the prescription and close monitoring by the IMF and the World Bank -- to bring about a 'reform' of the *chaebol* structure and system – has been a mixed bag of classical liberal measures, neo-liberal measures, and measures typical of developmental dictatorships. On the whole, the government, on the one hand, has failed to institute a new mode of regulations and processes to realise the reform and the maintenance of 'corporate governance', and on the other hand, in actually obtaining the necessary outcomes.

The adoption of consolidated accounting system [*kyulhapjaemujepyo* system], international accounting principles, establishment of auditing committee, strengthening of the accountability of directors, appointment of outside-the-company members of board of directors, lifting of the limitation on the voting rights of institutional investors, the strengthening of the right of minority shareholders, and the introduction of a system of class action are some of the measures introduced by the government aimed at the 'internal' aspect of the *chaebol* problem. The strengthen the power of the Fair Trade Commission was seen as one mechanism of controlling the outward behaviour of the *chaebol* firms – the 'external' aspects of the *chaebol* problem.

The IMF-WB also demanded the liberalisation of merger and acquisition and foreign investment, the prohibition of cross loan guarantee, and others – together with measures for greater labour market flexibility (making it easier to dismiss workers on the ground of redundancy) – as a part of the prescriptions aimed at diffusing the 'over-investment' problem of the *chaebol* system.*

1. The measures aimed at the 'internal' aspects are limited to inducing 'responsible and transparent management'. The government has made some efforts to remove 'dictatorial' aspects, but without addressing the issue of 'dynasty' that characterise the Korean *chaebol* system※. However, it would be difficult to institute a process and mechanism of selection of qualified management [or replacement of discredited management], while the dynastic power remains intact.

The government efforts have not penetrated the core problem of the *chaebol* system. While the government allowed creditors to seize the governance rights for those smaller *chaebol* firms which were allowed to undertake debt-equity swap, bringing about cases where the existing owner-chief lost the managerial rights or allowed to hold on to it conditionally, the *big five* were made immune from this process. For the *big five*, debt-equity swap did not bring about the loosening the grip the owner-chief had – rather the various measures, including the new capitalisation programmes, have turned into special privileges allowing the existing chiefs to strengthen their hold.

Furthermore, the *chaebol* reform pursued by the government excluded the possibility of encouraging employee participation in the ownership and management as the debt-equity swap that took place did not open the way for priority option to the employees or citizen in general [or any special arrangement for employee participation].

An assertive effort to address the 'moral' or 'political' aspect contained in the principle of diluting the power of 'owner-chiefs' would have enhanced the spirit of 'pain sharing' and 'responsibility sharing'. Furthermore, it could have created a better environment for stimulus measures.

2. In terms of the 'external' reform – the reform of the mechanisms to control the outward behaviour of the *chaebol* firms – the government has focused on independent management of individual member firms of the *chaebol* groups. However, the Financial Supervisory Commission insists that its

* However, much of the IMF-WB prescriptions were informed by the need to guarantee the repayment of debt and removing some of the obstacles for the take over of the Korean firms. However, it is not difficult to imagine that the measures for the retrenchment of domestic production facilities were – in part – designed to bring about the localised adjustment of the global production over capacity at Korea's expense.

※ In the days before the crisis, the term "*chaebol*" referred to the top 30 *chaebol* groups. But, in the course of the various adjustment process prompted by the crisis and the IMF/WB-prescribed measures, the ranks of "*chaebol*" are stratified into two categories: the big five and the rest. It is does not take much analysis to find the differences in the government treatment of the two classes of *chaebols*.

three-stage measure aimed at 'fostering the *chaebols* to become an alliance of independent companies' is not a project to 'dismember' the *chaebol* system.

It would be difficult to expect a substantial enhancement of the independence of individual companies in a *chaebol* group while the power of 'owner-chief' is maintained intact. Furthermore, the legislation allowing the formation of holding companies – while the power of 'owner-chief' is untouched – is tantamount to giving an anointed blessing to the power and position of 'owner-chiefs'.

The dominant position of the *chaebol* in the economy is likely to be further strengthened due to the unhindered transfer of burden to the SMEs or their sub-contractors. Furthermore, the *chaebols* are expected to come out as the biggest winners in the process of the 'restructuring' and 'reform' of the public corporations and utilities which will be brought to the market for sale.

3. The effort to redress over-investment is focused on establishing internationally capable 'national champions'. It calls on *chaebols* to get rid of non-performing member companies to be able to concentrated its energies on the core firms.

However, these efforts have had little or no effect on the major five *chaebols*. The companies belonging to the five largest *chaebol* listed on the stock exchange make up some 40% of the total asset of all the listed companies. A total of 343 cases of restructuring took place among the listed companies in 1998. This involved some 111 trillion won in assets. However, the restructuring involving the members of the big five was limited to 38 cases involving 3.5 trillion won – 3.2% of the total involved.

In December 1999, the owner-chiefs of the *big five* agreed with the president Kim Dae Jung to reduce the number of member companies. However, the total contribution of these targeted companies to the total revenue of each of the *chaebol* families range between 0.2% to 10.4%. Furthermore, the reduction of debt-equity ratio to 200% is expected, either to fizzle out, or to be undertaken through asset re-evaluation or issuing of new stocks [which will be swooped up by member companies to keep the control within the family]. Five companies from the big five were made subject to debt-equity swap. But, the government allowed the existing owner-chiefs to maintain management rights.

The austerity measures also contributed to the concentration and greater dominant positioning of the *big five*. This is seen in the fact that more than 80% of new equity issues and 70-80% of new CP issues were undertaken by the *big five*, monopolising the available funds at a time all companies were suffocating in the credit squeeze. The predilection for macro-economic financial austerity rather than micro-level credit rationing as an restructuring enforcement instrument, in fact, brought about the reverse of desired effect.

Furthermore, the big five *chaebol* groups refused resolutely to engage in any efforts, such as, abolition or sales of excess facility which could result in loss of capital. Instead, it insisted on reduction of workforce, heightening of work intensity, and wage cut backs. These efforts of resistance blocked all hopes of genuine reform-restructuring (of the *chaebol* system and diffusion of over-investment) while aggravating the suffering of workers and the credit crunch for all other companies.

The government's inability or unwillingness to address the issue of ownership-governance structure pressured it to opt for neo-developmental dictatorship measure of "big deal" – arm twisting swap of companies. It had the effect of distorting the whole parameters of corporate restructuring and causing unnecessary problems. Furthermore, the "big deal" is to be assisted by various facilitating "privilege", such as, debt-equity swap, debt forgiveness, and perhaps first option for future privatisation of large public corporations. The whole process does not contemplate the responsibility of owner-chiefs to inject the personal wealth to settle the debt incurred by "his" company nor his withdrawal from the management, leaving the question of moral hazard untouched.

The whole process fails to satisfy the criteria of fairness of burden sharing. At the same time, the "big deal" may not have the desired effect of diffusing the whole problem of over-investment.

### ***Concluding Remarks – change the matrix of interaction***

The government-promoted corporate restructuring fails to embrace employee participation in the ownership and management as an integral part. Furthermore, workers are excluded from the whole decision making process of restructuring and severely disadvantaged in the burden sharing matrix. Workers are not allowed to have any kind of 'ownership' of the process. Thus, they are asked just to bear with the process and shoulder all the burden generated by the process and the outcome. They are, in fact, painted into a situation where they are forced to act purely in reaction as 'unavoidably affected victims' (to a process that is created and undertaken without their participation) in which their natural and just response is to resist the 'change' which has ill-effects on their welfare and rights.

The distortion of the reform process brought an unhappy shift in the parameters of interactions surrounding the reform of the economic system which precipitated the economic crisis.

The government's legal action against some 500 trade unionists – including some 280 workers actually imprisoned – last year is the outcome of the reform that went wrong. The situation may not change in 1999, as the government continues to warn and threaten the labour with 'punishment' for any form of 'resistance' or actions to assert its just place in the process.

The labour is not unaware of the need for a radical overhaul of the Korean economic system. Rather, as its biggest victim, and one with most at stake – unable to move freely around to find better pastures – it is the most ardent proponent of a genuine reform. The labour's aim is to readjust the parameters of the change and reform so that it has a just and fair ownership in the process and the outcome. What needs to change first is the attitude which seeks to exclude labour for, among others, the fear of the possible disruptive effect of its participation, because, the history has shown, that this is the most dangerous kind of self-fulfilling prophecy.