Comment on “Evolution of the Business Groups in Korea and China” by Keun Lee

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Main Characteristics of Business Groups

- Ownership and control
- Group structure
- Diversification

Main Characteristics of Business Groups (1)

- Ownership
  - Family ownership (though usually not majority)
  - Cross shareholding among member firms
  - => Weaker pressure from outside investors
  - Weaker threat of takeover

- Control by founding families
  - Does it facilitate more long-term-oriented management?
  - Are the families best managers, particularly, the 2nd and 3rd generation families?

Main Characteristics of Business Groups (2)

- Group structure
  - Hiving-off (*bunshaka*)
  - Listing in stock markets of subsidiaries
    - The presence of minority shareholders and the worry on their exploitation through tunneling
  - Pyramidal structure with 2nd-tier, 3rd-tier, etc subsidiaries

- Question
  - Why not a complete control, e.g., a single firm with multidivisional form?
  - Why not a complete spin-off?

Main Characteristics of Business Groups (3)

- Diversification
  - Cross subsidization
    - From profitable but stagnant companies (“cash cows”) to growing, promising but cash-strained companies (“stars”)
  - Informational advantage and lower monitoring cost
  - The ease of combining complementary assets (both physical and human and both tangible and intangible)
  - But why not a complete integration?
    - Cross subsidization may hurt the subsidiaries’ minority shareholders.

- Presence of in-group financial sector (though under regulation in Korea)
  - Is preferential in-group loan justifiable with lower monitoring cost?

Three Theories (according to Prof. Lee)

- Market failure view
- Finance-based, agency-cost view
- Resource-based view

- These may not be really different because
  - All assume that information is imperfect and asymmetric, and monitoring is costly; but less so within business groups (BG)
  - All assume that contracting is costly; e.g., hiring outsiders is more costly than transferring workers within BG, and buying or licensing outside technologies is more difficult than using technologies developed by group firms

According to Prof. Lee's Study (slide 29-30)

- Over investment (investment to low-*q* industries)
  - Yes in 1990-95 but no in 2001-5
  - Is disinvestment or exit easier in BG?
  - What happened to investment in growing industries, particularly in industries requiring huge R&D and capacity investment such as semiconductors? (Long-term views made possible by weaker capital market discipline?)
- Strong chaebol advantage in 1991-95 but no such advantage in 2001-5
  - What does the 'advantage' mean?
  - The impact on *q* is negative in 1991-95 but positive in 2001-5.
  - Later analyses show smaller inefficiency after the 1997 crisis (slide 38)

What Are the Policy Implications?

- Implications for corporate governance
- Implications for industrial restructuring
- Implications for competition policy

Implications for corporate governance

- The (say) Anglo-American model
  - Separation of ownership from control
  - Independent outsider-dominated board of directors
  - Threat of hostile takeovers
  - Maximization of shareholder value
- The (say) East Asian Model
  - Limited shareholder control of the management
  - Shareholding by banks; cross shareholding
  - Rare occurrence of hostile takeovers
  - Insider-dominated board of directors
  - Room for discretionary behavior by the managers (family members or former employees)
- In Japan, the promotion of the Anglo-American model is on the way. What do Prof. Lee's findings teach in this regard?

Implications for Industrial Restructuring

- Firms in declining industries with excess capacity have to go or at least shrink (unless there is any hope of future turnaround)
  - Is BG helpful, e.g., by facilitating intra-group reallocation of excess resources (physical, human, or intangible)?
  - Or is it more desirable to have such firms simply liquidated, without causing excess burdens to other group firms?
- Is the revival of suffering firms (though with some promise) easier in BG?
  - Because of lower monitoring cost of BG compared to independent banks?
  - Or because of availability of knowledge and capabilities of other BG firms?

Implications for Competition Policy

- The presence of big business groups
  - May deter entry of new firms, intentionally or not.
- The seemingly better profitability of BG after 2000
  - May be because of this entry deterrence
  - May be because of tacit collusion among fewer big BG firms
  - May be because of tacit collusion facilitated through multimarket contact (Bernheim and Whinston, 1990)
- The superior bargaining power against outside suppliers of goods and services
  - May cause 'unfair' competition, e.g., "abuse of dominant market position" (Japanese Antimonopoly Law, 優越的地位の濫用)
  - A big pay difference between BGs and independent SMEs may testify to this

References (by Hiroyuki Odagiri)

- *Growth through Competition, Competition through Growth* (Oxford University Press, 1992), Chapter 7 "Business Groups"
- 『日本の企業戦略と組織』（東洋経済新報社、1992）、第7章「企業集団に実体はあるか」
- "The East Asian (Mostly Japanese) Model of Capitalism" in Dennis C. Mueller [ed.] *The Oxford Handbook of Capitalism* (Oxford University Press, 2012)