

Evolution of Corporate Governance in Korea After the Economic Crisis

Corporate Governance from an International Perspective:
Diversity or Convergence
RIETI
January 10, 2003, Tokyo

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Economic Reform Policy after the Economic Crisis

- “Four Economic Reform Policy” (1998)
 - Corporate reform
 - Financial reform
 - Labor reform
 - Public sector reform
- “5 Plus 3” Corporate Reform Principle
 - Agreement between Government and Chaebols
 - Improving corporate governance is a key policy

5 Plus 3” Corporate Reform Principle

- Five Principle Policy (February 1998)
 - Improving financial structure (reduction of debt)
 - Building competence core for chaebol groups
 - Enhancing transparency
 - Removing cross debt guarantee
 - Enhancing accountability of controlling shareholder & mgt.
- Three Additional Principle (August 1999)
 - Reducing circuitous equity ownership and unfair transaction among affiliated companies
 - Improving corporate governance of non-bank financial institutions
 - Strengthening gift and inheritance taxation

New Regulations to Improve Corporate Governance

- Outside Director
 - Required for all listed companies on KSE & KOSDAQ
 - More than 25% of the board should be outside director
 - For company with asset larger than 2 tr won (\$1.7bil), more than 50% of the board (2001) should be outside director
- Outside director candidate nomination committee
 - Mandatory for company with asset larger than 2 tr won
 - More than ½ should be outside director

New Regulations to Improve Corporate Governance

- Audit Committee
 - Mandatory for company with asset larger than 2 tr won
 - 2/3 of the committee should be outside directors
- Improved Disclosure
 - Combined financial statement for companies with asset larger than 2 tr won (\$1.7 bil)
 - Electronic disclosure system introduced
- Cross share ownership prohibited
- Cross debt guarantee prohibited

New Regulations to Improve Corporate Governance

- Limitation on equity holding of affiliated companies
 - No more than 25% of net asset value
 - Applies to chaebol groups with asset greater than 5 tril won (\$4.2 bil)
- More Regulation on Related Party Transactions
 - Related party transactions greater than \$8.3 million
 - Board should approve it
 - Should be disclosed immediately

New Regulations to Improve Corporate Governance

- Limit on Equity Ownership by Foreigner Removed
- Hostile Takeover Barriers Removed
 - M&A specialized fund allowed
- Holding Company Introduced
 - Holding company's debt to equity ratio should be less than 100%
- Cumulative Voting in Election of Directors
 - Opt-out system

New Regulations to Improve Corporate Governance

- Increased Responsibility of Controlling Shareholder
 - Fiduciary duty of directors
 - Liability of shadow director (controlling shareholder who does not seat on the board)
- Mandatory Compliance Officer
 - Investment Trust Co. & Mutual Fund
- Integrated Supervisory Agency Established
 - “Financial Supervisory Commission”
- Minority Shareholder’s Rights Strengthened

Minority Shareholders' Rights

Japan and Korea

Minority SH Right	Korea public co. (large c o.)	Japan
Action to remove directors and auditors	0.5% (0.25%) outstanding shares	3.0% voting rights
Seeking injunction against illegal acts	0.05% (0.025%) outstanding shares	Auditors may request that director cease illegal acts
Bringing shareholder derivative suit	0.01% outstanding shares	Any contemporaneous Shareholder
Limitation on directors liability	Not permissible	Permissible under Certain conditions
Compelling inspection of financial records	0.1% (0.05%) outstanding shares	3.0% voting rights

Minority Shareholders' Rights

Korea and Japan

Minority SH Right	Korea <small>public co.</small> (large co.)	Japan
Convening special shareholders' meeting	3.0% (1/5%) outstanding shares	3.0% voting rights
Making a shareholder proposal	1.0% (0.5%) outstanding shares	1.0% or 300 voting shares
Requesting cumulative voting	3.0% outstanding shares	Any shareholder, unless certificate provides otherwise
Appointing inspector to examine corporate affairs and records	3.0% (1.5%) outstanding shares	3.0% voting rights

New Regulation Proposed by New President-Elect, Mr. Roh

- Security Class Action Lawsuit
 - Stock price manipulation
 - Accounting manipulation and failed audit
 - False disclosure
- Separation of Financial Institutions from Industrial Company (Chaebol group)
- Strengthening taxation on gift and inheritance asset

Positive Changes in Corporate Governance

- Increased awareness on corporate governance
- Disclosures are more reliable
- Related party transactions decreased
- Investor relation is active
- New court rulings sets the standard
 - Derivative lawsuit:
 - Korea First Bank: \$33.3 million
 - Samsung Electronics Co.: \$81.4 million
 - Court ruling against “lack of business judgment”

Positive Changes in Corporate Governance

- Good corporate governance practicing companies
 - Kookmin Bank, POSCO, KT
- Active institutional investors
 - National Pension Fund
- Positive steps by controlling family
 - CJ Group chairman JH Lee gives up warrants worth of \$92 million
- Shareholder activism brings practical changes
 - PSPD : NGO shareholder activists group

Persistent Problems in Corporate Governance

- Old habits are hardly changing
 - Mindset of controlling family is the same
 - Persistent moral hazard
- Resistance from establishments
 - Political uncertainty
- Enforcement of regulation is not effective
- Independence of outside director in question
- Capital subsidy through financial institutions

Persistent Problems in Corporate Governance

- Expropriation of minority shareholders
 - Discounted Convertible Bond, Bond with Warrant
- Management control descended to 3rd Generation
 - Off-shore paper company operation
 - Equity issuance to family members using CB and BW
- Entrenched ownership structure
 - Control via ownership by affiliated companies
 - Pyramidal and circuitous ownership

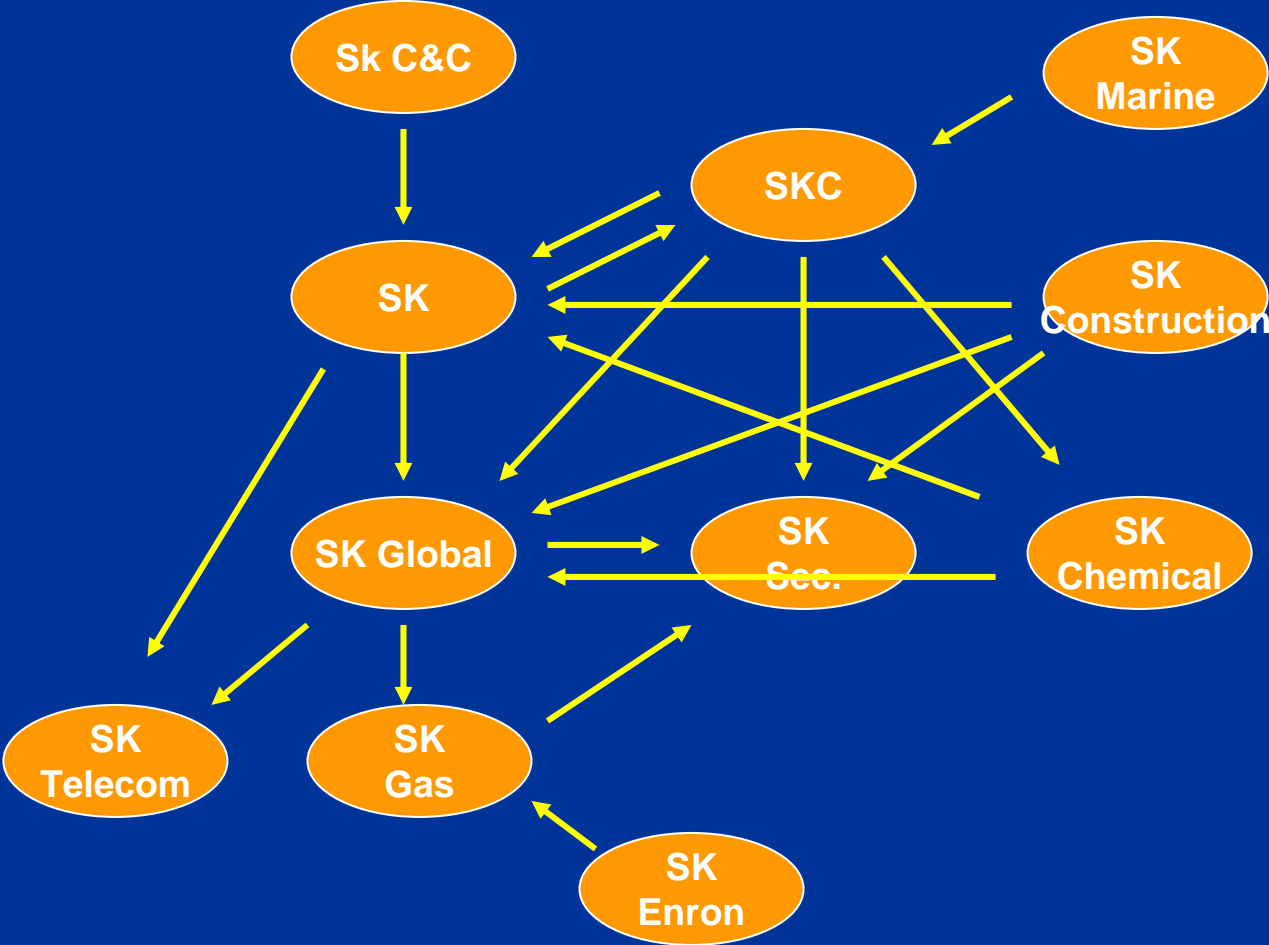
Source of Controlling Power

Top 10 Chaebols: Public and Private Companies

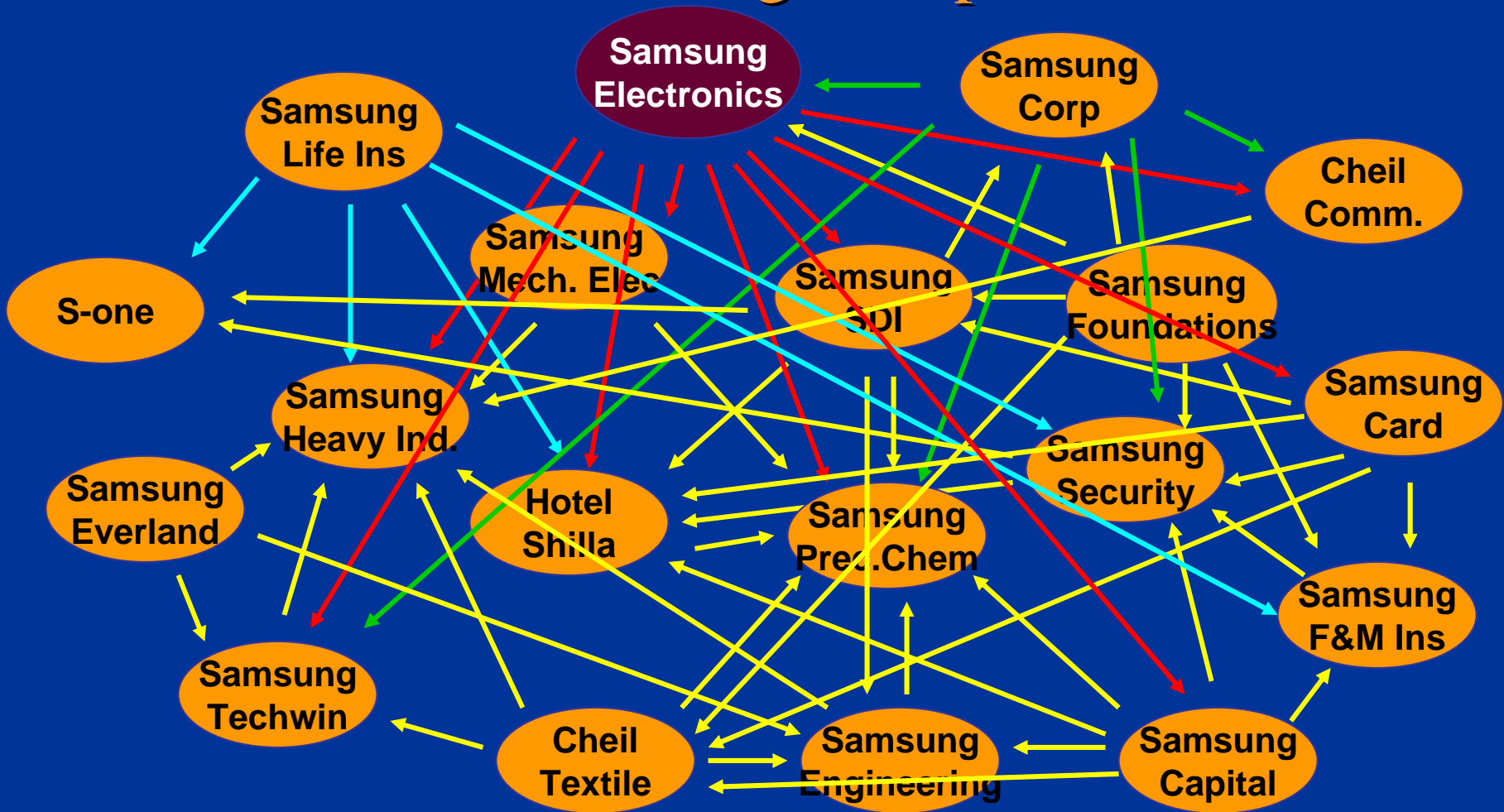
	Controlling Shareholder & Family	Affiliated Companies	Shares under Family Control
1997	9.54%	29.29%	39.57%
1998	7.82%	35.36%	44.16%
1999	5.76%	40.99%	48.07%
2000	4.30%	38.79%	44.72%
2001	4.29%	38.94%	47.61%

Pyramidal Equity Ownership

SK Group



Pyramidal Equity Ownership Samsung Group



Does Corporate Governance Affect Firm Value? Evidence from Korea

Bernard Black, Stanford Law School

Hasung Jang, Korea University Business School

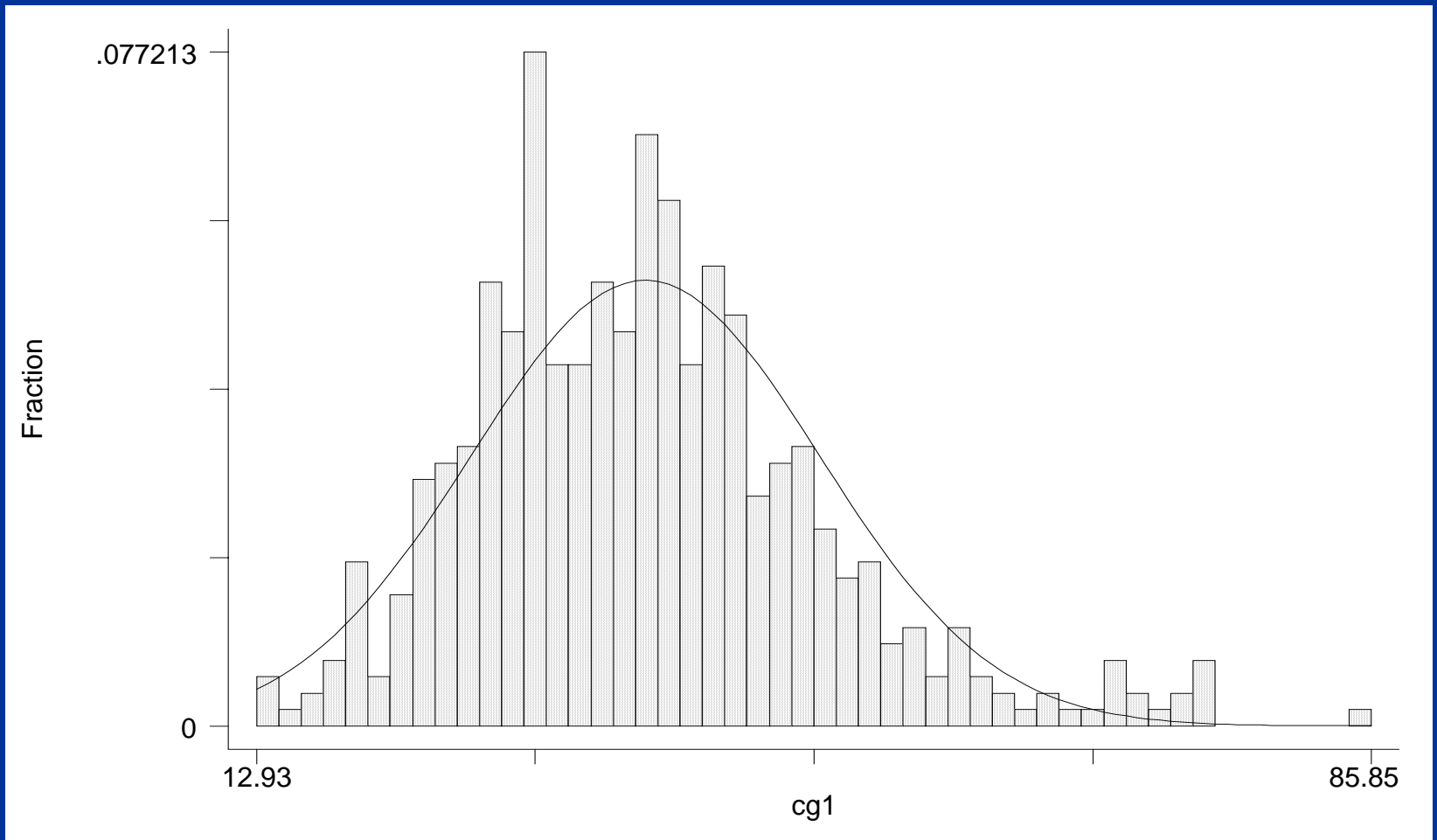
Woochan Kim, KDI School of Public Policy and Management

- Objective
 - Show empirical evidence that better corporate governance leads to higher firm value

Corporate Governance Index

- Survey by Korea Stock Exchange (KSE)
 - March – July, 2001
 - 493 companies in sample
- Index Construction
 - Shareholder rights
 - Board of directors in general
 - Outside directors
 - Audit committee and internal auditor
 - Disclosure to investors
 - Ownership

CG Index Distribution



Key Results

- Firms with better governance practice have higher firm value
- When controlling for endogeneity, the effect of corporate governance on firm value is even larger
- A 10-point increase in CG Index leads to an increase in market cap by 15.7% of book asset value
- Greater effect in outside directors and audit committee

What Will Expedite Changes in Corporate Governance?

- Corporation
 - Voluntary adaptation of global standard
- Market
 - Pro-active role of institutional investors
 - Reform of commercial banks
- Government
 - More direct regulations on corporate governance
 - Enforcement of regulations
 - Strengthening minority shareholder's right

What Will Expedite Changes in Corporate Governance?

- Legal System
 - Fair and effective court system
 - Fair and independent prosecution
 - Security class action suit
- Civil Society
 - Minority shareholder activist watch dog