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Plenary 3

New Stringent Avenues of Corporate Governance

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Transformation of Corporate Governance: The Korean Experience

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Outline

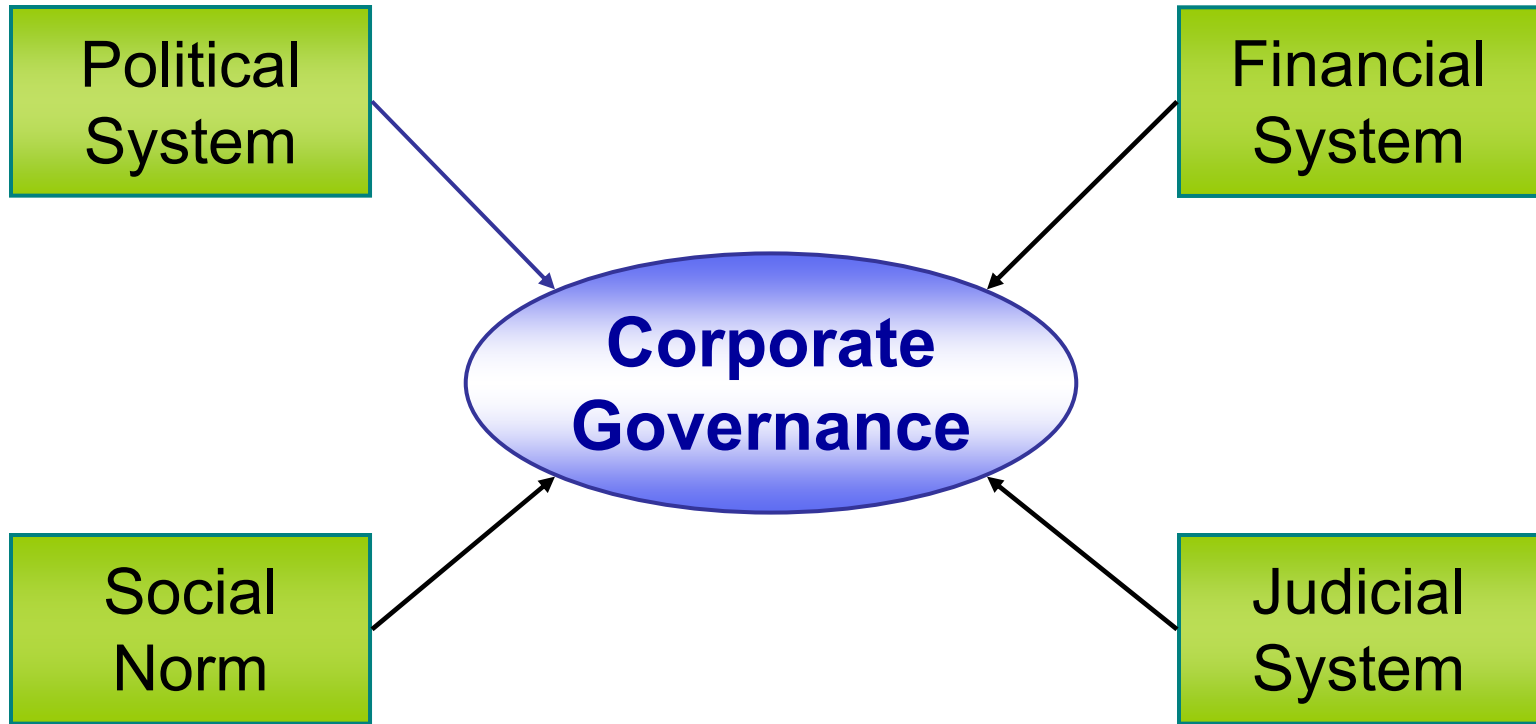
- I. INTRODUCTION
- II. CORPORATE GOVERNANCE IN THE PRE-CRISIS ERA
- III. TRANSFORMATION OF CORPORATE GOVERNANCE
- IV. CONCLUSION



I. INTRODUCTION

- Corporate governance in law is different from corporate governance in practice
- Corporate governance in law is a dependent variable, influenced by various element of “corporate governance ecology” (Tom Heller)

Corporate Governance Ecology



Change of Corporate Governance



- changes in the elements of corporate governance ecology precede any change of corporate governance in practice
- Korean case



II. CORPORATE GOVERNANCE IN THE PRE-CRISIS ERA

- 1. Determinative Factors
- 2. Corporate Finance
- 3. Corporate Governance
- 4. Evaluation



1. Determinative Factors

factors affecting the corporate governance in the pre-crisis era?

- development state model
- the rule of bureaucrats
- authoritarian regime



2. Corporate Finance

- - financial resources allocated by bureaucrats
- - banks under tight government control
- - heavily dependent on debt financing
- - high debt-equity ratio



3. Corporate Governance

- debt-financing lead to the concentration of share ownership
- dominated by controlling shareholders
- board and the general meeting remained mere formalities
- shareholder interests largely ignored



4. Evaluation

- phenomenal economic success
- stable system: compatible with the interests of those with power-entrepreneurs, politicians, bureaucrats, and even laborers
- underdeveloped capital market

III. TRANSFORMATION OF CORPORATE GOVERNANCE



- Driving Forces
- Recent Reforms
- Empires Strike Back
- Corporate Governance in Transition
- Challenge



1. Driving Forces

- Economic Growth: growing risk and uncertainty — not compatible with debt-financing
- Democratization: expansion of the rule of Law – limiting the room for discretion of bureaucrats
- Globalization: subject to the pressure from foreign investors
- Economic Crisis: existing corporate governance model under attack



2. Recent Reforms

- Board reform: outside directors, audit committee
- Strengthening minority rights
- Accountability of controlling shareholders
- Improving disclosure: combined financial statements, quarterly reports
- Restraining *chaebol* firms: prohibiting intragroup guarantee, limiting debt-equity ratio



3. Empires Strike Back

- the big business regains influence on politicians and the mass-media
- dwindling interest in further reforms:
ex. Securities class action bill
- challenging the existing *chaebol* regulations: ex. limit on the investment in sister firms

4. Corporate governance in transition



- Banks -> capital market
- Private benefit -> shareholder value
- Owners -> professional managers
- Management -> outside directors
- Bureaucrats -> lawyers
- Group structure-> individual firms



5. Challenge

- Investor protection strengthened
- Outright theft of corporate resources is becoming difficult
- Control shareholders still dominant and not much interested in shareholder value:
 - income not related to the share prices
 - little chance of hostile takeover
- Challenge: how to make them more sensitive to the shareholder value?



IV. Current Development

- Recent Scandal
- Role of the Regulators
- Rise of the Holding Co. Structure
- Strengthening the Role of the Market Forces



1. Recent Scandal

- Accounting fraud of the SK Group
- Chairman Choi, the controlling shareholder, and convicted for multi-billion dollar accounting fraud – still leading the SK Group
- Chairman Sohn, convicted and under investigation for illegal political contribution – still leading the Federation of Korea Industries, a trade association for the big business



2. Role of the Regulators

- Two areas: -audit and disclosure
-financial regulation
- Audit and disclosure: try to further strengthen the system following the Sarbanes-Oxley
- Financial regulation: dealing with *chaebol*-affiliated financial firms

3. Rise of the Holding Company Structure



- Growing interest in the holding company structure
- 19 groups (including LG) now adopt the holding company structure
- Government, FTC in particular, is generally in favor of this change
- Positive change?: simplifying the ownership structure

4. Strengthening the Role of Market Forces



- not many options
- competition: owner-governed firms vs. professional manager-governed firms
- competition: holding co structure vs. cross-shareholding structure
- establishing a special section for “shareholder value-oriented firms” at the Stock Exchange



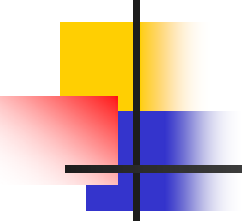
V. Conclusion

- The presence of controlling shareholders does not go well with the vibrant stock market
- Two sides of the controlling shareholders
 - private benefit of control
 - source of stability



V. Conclusion-continued

Q: Can Korean firms thrive in the absence of controlling shareholders?



Thank you.