

The Reform of Corporate Governance in Korea with an Emphasis on the Hyundai Group

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Abstract: This article analyzes changes in corporate governance institutions in Korea with an emphasis on the Hyundai Group. It is based mainly on historical institutionalism. In particular, it focuses on power struggles between pro-reformers and anti-reformers. According to Krasner (1984), an institutional change after a long period of equilibrium results in a radically new institution. However, it is not the case in many cases. Entrenched interests, in reality, tend to desperately resist reforms or compromise with pro-reformers. Consequently, a resulting institution reflects the interests of both pro-reformers and anti-reformers. This means that a new institution cannot be a totally new one but follows its historical path. We can find the same logic in the chaebol reforms since 1998 in Korea. The Hyundai Group, a classic Korean chaebol, verifies the logic very well.

INTRODUCTION

The purpose of this article is to explain corporate governance reform in Korea between 1998 and 2000. The article presents two arguments concerning the 'degree' of the reform and its 'determining factors.' As for the degree issue, the paper argues that institutions tend to change gradually, not radically. According to Krasner's idea of punctuated equilibrium, punctuated change would have led to significantly new institutions. This article, however, argues that the existing power structure affects institutional change and effects piecemeal change in the end. With reference to the determining factor, it is argued that the logic of market-driven efficiency was not sufficient to explain the results of the reform; rather the logic of politics is decisive. Many different relevant actors were concerned with corporate governance. Thus, its reform accompanied changes in the existing power relations and led to power struggles between the interested parties. Accordingly, corporate governance can be well understood from the perspective of politics.

The article is concerned with the thirty largest

Korean chaebols, but it focuses on the Hyundai Group. The Group had the largest assets among Korean chaebols. Although it was demoted to second place behind the Samsung Group on April 1, 2001 in a list issued by the Fair Trade Commission (FTC), it had occupied the top position from 1987 to 2000 and is actually still number one.¹⁾ In addition, the Group had been deemed the prototypical of Korean chaebol. It has a centralized decision-making structure, and the head has governed all subsidiaries without significant checks and balances.

The article is devolved from many information sources. The author interviewed eleven people from nine organizations including the Hyundai Economic Institute. The primary source material is diverse: the FTC, the Korea Stock Exchange (KSE), the Bank of Korea (BoK), the Federation of Korea Industry (FKI) and the People's Solidarity for Participatory Democracy (PSPD). The article also

1) The explanation is that Hyundai and KIA Motors Co. were separated from their parent group to form another group, which occupied the fifth place on the list. Thus, if the two groups were combined, their assets would far exceed those of the Samsung Group (www.ftc.go.kr).

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uses daily newspapers, weekly and monthly journals. The author was also able to exploit e-mails from journalists and information from websites.

From the standpoint of institutionalism, the article regards corporate governance as an institution. Corporate governance is the institutional structures and processes that hold managers accountable to owners for performance and through which external actors check corporate power. It is a series of procedures which relevant actors accept as natural. It functions as a framework when they take actions. The article is also written from the perspective of gradual institutional change, and it highlights political factors to support this position. It suggests that political struggles and compromises among interested parties are decisively influential on newly shaped institutions and lead to gradual change.

The subsequent section is on theoretical issues. It covers the chaebol model, types of institutional change and paradigms to explain those changes, and the three levels of power. The next two sections focus on the power resources of reform advocates and the chaebols. Then the governmental policies and the reactions of the chaebol are analyzed. This section focuses on the resistance of the Hyundai Group to the reform policies and a political compromise. Finally, the article generalizes the implications of the Hyundai Group case to other Korean chaebols.

THEORETICAL DISCUSSIONS

Chaebol Model

Corporate governance in Korea is usually labeled 'the chaebol model.' Chaebol means family-dominated group corporations. A patriarchal head governs all affiliates by relying upon control mechanisms such as the Planning and Coordination Office and the President's Council. Mutual debt-guarantee and circular ownership among affiliates

also contribute to governing power of the head. The affiliates are normally unrelated and diversified.

The model took shape under the influence of the Japanese pre-war *zaibatsu* during the Japanese colonial era. Yet the chaebol had not flourished by the 1950s because the political-economic situations were insecure immediately after liberation and, due to the Korean War and its aftermath, the situation remained stagnant until the 1960s. When General Park Jung-Hee took political power, he began to institutionalize the chaebol in 1961. The process had settled down by the end of the 1970s.

Superficially the chaebol seems similar to Japanese pre-war *zaibatsu* and post-war *keiretsu*. A closer look, however, reveals the differences between them. The chaebol are significantly different from the pre-war *zaibatsu* in two points. First, the chaebol were not allowed to govern banks. In contrast, the pre-war *zaibatsu* could govern banks as an affiliate, and thus enjoyed financial independence from the state. Second, chaebol scions, regardless of managerial capability, often inherited their parent's wealth and management rights. In the *zaibatsu*, only capable family members were permitted wealth and management rights. If there were no capable family members, adopted sons inherited the wealth and management rights. Thus, from the *Dokukawa Baku* period²⁾, a professional management system was established in Japan.

The chaebol are also different from the Japanese post-war *keiretsu*. All employees are considered to have partial ownership in the *keiretsu*. In the chaebol however, employees are merely a cost factor. The Presidents Council decides strategic policies and expels inefficient affiliates in the *keiretsu*, but that function is no more than a formal mechanism in the chaebol where pre-decided strategies are disseminated by the head. In the main operating mechanism, while consensus building is the main concern in the *keiretsu*, hierarchical order

2) Clarke, 1979: Chapter 2.

works in the chaebol.³⁾

Radical Change versus Gradual Change

Borrowing the term 'punctuated equilibrium' from paleontologists S. J. Gould and N. Eldredge, Krasner argues that institutions do not continuously respond to changing environments. Rather, they change rapidly after a relatively long and stable period and then a significantly different new institution appears.⁴⁾

On the other hand, North argues for gradual institutional changes through 'negotiation and bargaining.'⁵⁾ When an institution changes, there is a process of bargaining among people who benefit from the change, people who benefit from its maintenance, and people with different opinions concerning new institutions.⁶⁾ Institutional change is a product of negotiation. In this way, existing institutions strongly influence newly shaped institutions and there is path dependence in institutional changes.⁷⁾ It is very difficult for the new institution to be significantly different from the existing one. Likewise, Skowronek stresses gradual changes through 'resistance and struggles.' He argues that environmental changes are no more than stimuli for institutional change.⁸⁾ Vested interests would resist institutional changes because the changes might undermine their power and status. For instance late in the nineteenth century, U.S. political parties opposed a new civil service system because they worried that the new system might take away the benefits of favoritism.⁹⁾ Courts also tried continuously to regulate the railroad industry, by opposing the institutionalization of the ICC.¹⁰⁾ In this

way, political struggles among interested parties prevent radical institutional changes.

Economic Paradigm versus Political Paradigm

Concerning the explanation of economic changes, there are two different paradigms: economic and political. The economic paradigm is well advocated by Berle and Means. They argue that the emergence of new large-scale corporations and new corporate governance are natural economic outcomes. In the U.S.A. at the beginning of the twentieth century, technology and the 'economy of scope' caused the dispersion of share-ownership and the power shifted from owners to managers.¹¹⁾ To realize the 'economy of scale' under new technologies, it was necessary to have a larger company, and the original shareholders had to dilute their equity by issuing more stocks in order to enlarge companies. As a result, share-ownership was dispersed and power shifted from owners to managers.

On the other hand, Polanyi stresses political factors by arguing that the development of the woolen industry and its extension to the industrial revolution in the U.K. were indebted to consistent public policies implemented by politicians at the end of the Tudor and at the beginning of the Stuart reigns.¹²⁾ Those politicians controlled the pace of economic changes to a degree that British society could bear. In addition, they prevented economic changes from devastating society by implementing policies to relieve the poor who had been forcibly removed from their places of residence through Enclosures. In the same context, Roe explains U.S. corporate governance by referring to political factors. He argues that the dispersion of share-ownership and the low equities of institutional shareholders are indebted to the regulative policies of the U.S. government, not the result of a natural

3) Abegglen and Stalk, 1985: Chapter 8.

4) Krasner, 1984: 240, 242, 243.

5) North, 1990: 6.

6) *Ibid*, 90-91.

7) *Ibid*, 101.

8) Skowronek, 1982: 12.

9) *Ibid*, Chapter 3.

10) *Ibid*, Chapter 5.

11) Berle and Means, 1967: 47-110.

12) Polanyi, 1944: 37-38.

economic evolution.¹³⁾ As the U.S. government had implemented policies to regulate share-ownership by banks, insurance companies and trust funds since the end of the nineteenth century, the equities of institutional shareholders were reduced and diverse personal shareholders came to own stocks.

Three Levels of Power

Synthesizing the existing theories, Levy and Egan categorize the power of business over the State into three levels: instrumental, structural and discursive.¹⁴⁾ The instrumental level emphasizes a dense network of relationships between business and the State, which include membership in political or social organizations, the revolving door of decision-making personnel between business and the State, and politicians' dependence on private donations to fund election campaigns. The structural level stresses that in a market system, the State is structurally dependent on private sector profitability. State managers depend on popular support and legitimacy, which is a function of jobs and prosperity in the private sector and their ability to fund government programs with tax revenue. Thus they have to consider business interests, although they are independent of business at the instrumental level. The discursive level focuses on the ideological and symbolic aspects of power. Business has the power to affect the agenda setting of public policy, public opinion and the arena of social discourse.

POWER RESOURCES OF PRO-REFORMERS

Principal reform advocates are the International Monetary Funds, the Presidential Office, the Ministry of Finance and Economy (MoFE) and the

PSPD. The Financial Supervisory Commission (FSC), FTC, KSE and commercial banks helped the principal advocates with day-to-day matters. The Ministry of Justice, Korea Development Institute, Korea Securities Research Institute (KSRI) and Citizen's Coalition for Economic Justice (CCEJ) also advised or cooperated with the reform advocates.

Pro-reformers had the following power resources over anti-reformers. The current government had instrumental autonomy from the chaebol. Thus they were able to implement policies with relatively weaker personal barriers than in the former government. President Kim Dae-Jung had been a dissident political leader and excluded from the ruling developmental coalition. In addition, the current government has a different provincial base of political support, the Southwest Jeolla province, which was different from that of the previous governments, whose base was in the Southeast Gyeongsang province. Meanwhile, most chaebol did not have the Jeolla personal network because they had discriminated against the Jeolla people for political reasons. As a result, the current government is relatively independent of any personal networks.

The government has also completely controlled the commercial banks, the main financing resource of the chaebols. After the economic crisis, government-directed financing increased. As the government directed public money into the banks to rescue them, the banks were changed to government-invested companies. Although chaebol affiliates increasingly depended on direct financing from stock markets, fifty-five of the sixty largest chaebol are still under the direct influence of government-invested banks.¹⁵⁾

Furthermore, the government was able to control the chaebol by selectively applying laws to them. The government obtains adequate information on

13) Roe, 1994: 26-48.

14) Levy and Egan, 1998: 337-361.

15) *WolGanChoSun*, September 2000, monthly.chosun.com.

the weaknesses of chaebol heads via tax investigations by the Inland Revenue, wrongdoing investigations by the Prosecution and the secret information services. Nonetheless, it does not punish them as soon as it uncovers the wrongdoing; rather it keeps this information in order to exploit it when needed. In addition, it continued to regulate market entry in promising industries by issuing licenses or implementing rationalization policies. Lastly, and perhaps most powerfully, the government and other pro-reformers could refer to the IMF and foreign investors to press anti-reformers to agree with reforms.

Based on these power resources, the MoFE has even checked the FKI, which is a purely private peak organization of chaebols, by promoting a rival, the Korea Council of Commerce and Industry, a quasi-government organization. In addition, a former Minister, Lee Heon-Jae, stated off-the-record several times that the FKI should be disbanded.¹⁶ The government also exerted pressure to dismiss a high FKI official, Yoo Han-Soo, who had strongly criticized government policies concerning corporate governance reform.¹⁷ It forcibly removed two strong opponents from the FKI, including Gong Byong-Ho, a former chief of the research institute of the FKI. It also intervened in the internal operation of the FKI and discouraged one of the family members of the five largest chaebol from taking office as the Chairman of the FKI in 1999.

POWER RESOURCES OF ANTI-REFORMERS

Power Resources of Chaebol

The chaebol had a number of resources with which to oppose the pro-reformers. Initially, they

had instrumental power resources. They had direct personal or financial links to the current ruling party, even though their power was much weaker than in the former government. They provided legal (and illegal) political money to political parties in the last presidential election in 1997. Although the current ruling party received much less money than the former ruling party did, it is undeniable that it received political funds from the chaebol.¹⁸ In addition, it continued to need enormous amounts of political funds. As seen in Table 1, the Jeolla province, the political base of the ruling party, has a small portion of the electoral roll, 12.10 per cent, and thus the ruling party must obtain votes in other provinces such as Seoul, Gyeonggi, Incheon, Gangwon and Jeju to stay in power.

To do this, money is necessary because money still affects unaffiliated voters without strong provincial sentiments. These voters account for 52.58 per cent of electoral roll. This means that the ruling party again needs considerable political money in the coming presidential election in 2002. Chaebol also influences civic groups such as the CCEJ by contributing to their budgets. In an interview on August 25, 2000, Wi Pyoung-Ryang, Vice-Director of the Policy Research Board of the

Table 1. The Current of Distribution of the Electoral Roll

Province	Electoral roll	Weight (%)
Seoul	7,505,246	52.58
Gyeonggi	6,151,379	
Incheon	1,721,234	
Gangwon	1,113,504	
Jeju	375,025	
Choongchung	3,363,249	10.49
Jeolla	3,880,711	12.10
Gyeongsang	7,965,148	24.83
Total	32,075,496	100

Source: adapted from www.nec.go.kr/sinfo/sinfo.htm as of April 13, 2000.

16) FKI, anonymous interviewee.

17) *JooKanChoSun*, August 17, 2000.

18) *IYoSinMoon*, December 30, 1999.

Table 2. Main Shareholders of Newspaper Companies

Newspaper	Main shareholder	Newspaper	Main shareholder
<i>HanKook KyoungJeSinMoon</i>	The FKI	<i>KyounghyangSinMoon</i>	Hanwha
<i>JoongAngIlBo*</i>	Samsung	<i>DongAllBo</i>	Samyangsa
<i>MunWhallBo</i>	Hyundai	<i>KookkJeSinMoon</i>	Lotte
<i>BuSan MaeIlSinMoon</i>	Daewoo	<i>KangWonIlBo</i>	Dongbu
<i>BuSan KyoungJe</i>	Daewoo		

Source: Choi, H. C., 1999, p. 148.

* *JoongAngIlBo* is owned by the Bokwang Group. However, the head of the Bokwang Group is a brother-in-law of Samsung's head.

CCEJ, said that the organization received money via the personal networks of its members. (It is interesting to note that some of the thirty largest chaebol provided money to the group.) Of course, he stressed that the group did not receive any money from any controversial chaebol. However, one cannot know in advance all the things that the chaebol are doing and whether or not their activities will be controversial in the future.

Chaebol also wielded excessive structural power. That is, they occupied privileged positions in capitalistic society to affect public policies, without having direct links to policy-makers.¹⁹⁾ The weight chaebol carry in the national economy is too high, so they can influence things as they wish and hold the national economy hostage. If the government takes action against chaebol only according to market principles, it is highly likely to face serious difficulties. Chaebol also command significant psychological weight in the mind of the public. Most people regard chaebol as the national economy itself. Thus if the leading chaebol collapse, people are likely to feel anxious and criticize government policies. In particular, chaebol had strong influence on the government concerning their reunification policy, which is known as 'the Sunshine policy.' As the current President contended for the Nobel Peace Prize based on improving relations with North Korea, investments in North Korea were essential, and the government despera-

tely hoped for the chaebol to invest in North Korea. As initial investments in North Korea could not make profits, however, the chaebol had to endure short-term deficits. Accordingly, the government was obligated to the chaebol and was forced to oppose them with a somewhat muted voice.

Chaebol also exerted discursive power. They could powerfully influence or even shape social discourses. They affected public opinion in civil society and thus prevented the public from perceiving the problems the chaebol had created. They exploited the mass media for this purpose. As can be seen in Table 2, key chaebol have controlled many newspaper companies. The FKI also had a newspaper company to protect the common interests of chaebols. Moreover, although they did not have direct control, chaebol could influence other newspaper companies through advertisements. As newspaper companies cannot survive without advertising revenue from advertisements, they could not ignore the demands of the chaebol. Besides, many chaebols owned journals, CATV, Electric Board News and Ad companies.²⁰⁾ Chaebol also affected the economic policies of the government. The member companies of the FKI paid membership fees and jointly prepared policy alternatives via the research institutes installed in the FKI. After thorough preparation, they proposed these alternatives to the government at seminars and roundtables. In the 1990s, the FKI turned

19) Lindblom, 1977: 175.

20) Choi, 1999: 148.

ninety per cent of their proposals into government policies.²¹⁾ In addition, the leading chaebol have their own economic research institutes consisting of first-rate economists. These institutes significantly affect economic and social discourses in Korea.

Power Resources of the Hyundai Group

The Hyundai Group has exerted a number of instrumental power resources. It has maintained such a close relationship with the Kim Dae-Jung Government (1998~2002) that one joke is, "The Kim Young-Sam Government (1993~1997) was the Republic for the Samsung Group and the Kim Dae-Jung Government is the Republic for the Hyundai Group."²²⁾ This Group supported the current President in the last presidential election in 1997 and has continuously donated to the ruling Democratic Party but given no money to the opposition Grand National Party.²³⁾ In 1998 alone, it gave US\$1.6 million to the ruling party in legal donations alone.²⁴⁾ In addition, family members of the founder have played active roles in the public arena. Jung Mong-Joon, the sixth son of the founder, is an independent Member of the National Assembly and has earned an esteemed reputation as a Vice-President of FIFA. Jung Mong-Koo, the second son of the founder and the chair of Hyundai Motors Co., has also acted as the chair of the Committee for Attracting the 2010 World Trade Fair.²⁵⁾ Furthermore, the lobbying power of the Group was so strong that it incapacitated the National Assembly.²⁶⁾ The Group also influenced a

cabinet reshuffle in August 2000. Before the reshuffle however, the Group submitted a petition to the Presidential Office to persuade the core politicians of the ruling party to remove the Chairman of the FSC and the Minister of Finance and Economy who had been very antagonistic towards the Group. The two Ministers were replaced. Although there may have been several other reasons for their replacement, the lobby was certainly one of them.²⁷⁾

The Hyundai Group also exerted strong structural power. It had a considerable influence over the national economy. Initially the Group had its affiliates in nearly all sectors: publishing, furniture-making, oil refining, steel making, auto production, electronics, energy, construction, retailing, transportation, telecommunication, broadcasting, international trade and finance. As of April 1, 1998, the Group had sixty-two affiliates.²⁸⁾ The wide range of business interests show that the diversification had not been sought for the benefits of the 'economy of scope'. This is clearly an unrelated diversification. It seems that the founder sought structural power or a privileged position in the Korean economy rather than just economic efficiency or profits. As of 1997, the Group carried undue weight in the businesses in which it was involved. For instance, it controlled 6.4 per cent of steel making, 20.7 per cent of auto production and 19.5 per cent of international trade.²⁹⁾ Furthermore, the sum of the sales of the Group, US\$62,944.8 million, was the largest among the chaebol in 1997.³⁰⁾ The group

21) Kim, Y. T., 1999: 158.

22) *WolGanChoSun*, February 1999.

23) *ChoSunIlBo*, May 4, 2000.

24) *IYoSinMoon*, October 3, 1999. The exchange rate of Korean Won against U.S. Dollar is 1,250 Won to 1 Dollar. It is the same through the article.

25) *Ibid*, December 9, 1999.

26) The Political Committee of the National Assembly chose Mong-Heon Jung, the fifth son of the founder, as a testifier in the 1999 regular session. However, he did not attend the committee. In this kind of case, the

National Assembly should commence a legal action according to Article 15 of the *Law for the Testimony and Appraisal in the National Assembly of 1990*, but it did not. Both the ruling Democratic Party and the opposition Grand National Party were not willing to file the legal action (*HanKeoRe*, December 15, 1999).

27) *ChoSunIlBo*, March 27, 2000; *HanKeoRe*, March 30, 2000; E-mail from Young-Shin Yoon, journalist of *ChoSunIlBo*.

28) www.ftc.go.kr.

29) PSPD, 1999: 115.

also contributed much to the Korean export business. Hyundai Motors Co. and KIA Motors Co. had net trade surplus of US\$14.6 billion in 2000, but the total trade surplus of Korea was no more than US\$11 billion in the same year.³¹⁾ Considering these contributions to the Korean economy, it is undeniable that the Group had strong structural power in Korea. This structural influence also can be easily perceived in the changes of the Korea Composite Stock Price Index (KOSPI) for two months in 2000 when there were fraternal struggles for corporate control of the Group. On February 29, 2000, the KOSPI was 828.38. In contrast, it plummeted to 692.07 on April 27, 2000.³²⁾ The main reason for the decline is generally believed to have been the withdrawal of foreign investors who had become nervous over the fraternal infighting. The Group strongly affected the Korean stock markets, even though it was no more than 'one' group.

At a discursive power level, the Group also has power resources. It has had a strong policy capacity and has expressed its policy preferences when the occasions arose. Sometimes, the researchers of the Hyundai Economic Institute criticized government policies from theoretical and logical perspectives. When necessary, it also could cooperate with other chaebol via the FKI. In addition, as seen in Table 2, the Group owns a daily newspaper *MunWhallBo* and has considerable influence in the daily newspaper *HanKook KyoungJeSinMoon*. Above all, the Group has gained legitimacy because it has been seen as a source of national pride. In particular, Hyundai Construction Co. raised national pride among Middle East and South East Asian countries because the company completed large-scale, very difficult construction projects there. In this regard, the Group and the founder have the respect of many Koreans. In particular, the

indomitable will of the founder has been inspirational and many people followed his philosophy.³³⁾

GOVERNMENTAL POLICIES AND THE REACTIONS OF THE HYUNDAI GROUP

Since 1998 the Korean government has implemented policies in two areas: the restriction on the diversification of the chaebol and the weakening of the power of heads within chaebol affiliates. With regard to the former, the policies were to disband the Planning and Coordination Office and the Presidents Council, dissolve mutual debt-guarantee, regulate crossed share-ownership among affiliates, simplify and specialize business sectors, strengthen the regulations on financial affiliates and investigate unfair internal transactions. In connection with the latter, policies were concerned with board structure and composition, strengthening the power of smaller shareholders, the cumulative voting system and hostile takeovers.

The Policies to Restrict Diversification

Concerning the repeal of the control tower of each chaebol, the Hyundai Group established the Headquarters for Restructuring to replace the Planning and Coordination Office and maintained the Presidents Council. In addition, the founder continued to act as an honorary chair by visiting North Korea as a representative of the Group, although he resigned all posts.³⁴⁾

With reference to improving financial status, the Group reduced the debt/asset ratio from 573.77 per cent late in 1997 to 181 per cent late in 1999.³⁵⁾ Yet, it did not repay debts; rather it increased assets through cross share-ownership among affiliates in

30) *Ibid*, p.63, 74, 83, 93, 101.

31) www.bok.or.kr; *JoongAngIlBo*, March 12, 2001.

32) www.kse.or.kr.

33) *ChoSunIlBo*, March 25, 2001.

34) *Ibid*, June 16, 2000.

35) *MaeIlKyeongJe*, October 31, 1998; *WolGanChoSun*, January 1999; *HanKeoRe*, April 27, 2000.

order to satisfy the debt/asset ratio requirement. The founder and his sons mobilized affiliates' money rather than input new money and strengthened their governing power through the cross share-ownership. In this process, Hyundai Construction Co., Hyundai Heavy Industries Co. and Asan Foundation became factual holding companies.³⁶⁾ As of April 1999, the equity of affiliates was 50.5 per cent, higher than that in other chaebols.³⁷⁾ As seen in Table 3, the amount of mutual share ownership among affiliates was second to that in the Daewoo Group. In particular, the affiliates' equity in financial affiliates was much greater than that in other affiliates. As of the end of September 1999, the average equity by affiliates in the five largest chaebols was 53.5 per cent, but the affiliates' equity in Hyundai financial affiliates was sixty-two per cent.³⁸⁾

Table 3. Mutual Share Ownership in the Ten Largest Chaebols

No. of affiliates Owning shares of other affiliates		Amount of invested money (U.S. \$ million)
Hyundai	14	1,797.8
Daewoo	4	2,732.1
Samsung	11	880.9
LG	9	1,446.5
SK	5	373.4
Hanjin	7	65.4
Ssangyong	2	240.8
Hanwha	2	54.6
Keumho	3	146.1
Lotte	2	9.3
Total	59	7,747.2

Period: July 1998 June 1999

Source: *ChoSunIlBo*, July 15, 1999; recited from the material issued by the KSE.

36) *WolGanChoSun*, January 1999.

37) *ChoSunIlBo*, July 13, 1999. In the same period, the equity of affiliates was 48.0 per cent in the LG Group, 47.5 per cent in the Daewoo Group and 39.2 per cent in the Samsung Group.

38) *HanKeoRe*, October 7, 1999; recited from the Material for Auditing in the National Assembly presented by the FTC.

In connection with the simplification of business sectors, the Group has been reluctant to sell main affiliates and thus sold only small companies and parts of big companies. On the contrary, it took over the faltering KIA Motors Co. in 1998, LG Semiconductor Co., Hanwha Energy Co., Kangwon Industries Co., Sammi Special Steel Co. and Hyundai Life Insurance Co. in 1999. In particular, in the case of the semiconductor industry, although the debt/asset ratio of the LG Semiconductor Co. was 617 per cent and that of the Hyundai Electronics Co. was 935 per cent as of the end of June 1998, the latter took over the former.³⁹⁾ In addition, it further invested in North Korea.⁴⁰⁾ Furthermore, it delayed the Economic Restructuring Schedule, previously agreed upon at the first Roundtable between the Government and the Chaebol on July 26, 1998, and acted more covetously than other chaebol.⁴¹⁾ Considering that the government did not allow the five largest chaebols to enter new business lines in 1998 and 1999, the above actions are further indications of preferential treatments.⁴²⁾ Accordingly, as can be seen in Table 4, the number of affiliates of the Group increased from 57 on April 1, 1997 to 62 in April 1999.

Table 4. The Number of Affiliates of the Four Largest Chaebols⁴³⁾

	April 1997	April 1999
Hyundai	57	62
Samsung	80	49
LG	49	48
SK	46	41

Source: www.ftc.go.kr

39) *MaellKyongJe*, September 4, 1998.

40) *WolGanChoSun*, January 1999.

41) *MaellKyongJe*, September 4, 1998; *ChoSunIlBo*, June 21, 1999.

42) *ChoSunIlBo*, June 2, 1999.

43) The criterion for affiliation is thirty per cent of equity by the head or other affiliates.

The Policies to Weaken the Head within an Affiliate

Concerning board composition, all affiliates of the Group filled forty-three per cent of their boards with non-executive directors (NEDs).⁴⁴⁾ In particular, Hyundai Motors Co. filled four of eight directors with NEDs and removed Jung Mong-Heon, the fifth son, from the board in March 2000. In addition, it decided to provide stock options to 104 officials and NEDs. This means that the Group was seen as closely following the governmental policy that recommended that companies fill one third of the board with NEDs. The Group, however, actually ignored the policy at significant moments, as will be seen by the fraternal infighting discussed below.

The Group totally ignored the demands of minority shareholders, who demanded the strengthening of the status of small shareholders. The PSPD, one of the most vociferous anti-chaebol civic movement groups, focused on Hyundai Heavy Industries Co. among the affiliates of the Hyundai Group, but the company disregarded the movement.⁴⁵⁾ On the contrary, the company held an annual general meeting at the same time as other companies such as SK Telecom Co. and Samsung Electricity Co. on which the PSPD was also focusing. In addition, the company had its employees occupy the seats during the meeting.

Concerning the repeal of the control tower, the Group disbanded the Planning and Coordination Office but established the Headquarters for Restructuring that would perform the same function. In connection with improving financial status, the debt/asset ratio was lowered. The Group, however, achieved this by raising the equities of affiliates, not by repaying debts. With reference to simplifying business sectors, the Group increased them, a ploy which ran counter to government policy. In

relation to NEDs, the Group followed governmental policy by increasing their ratio on boards. However, the NEDs could not hold the controlling shareholders properly in check. In respect to the minority shareholders' movement, the Group totally ignored the movement. Based on these results, it can be said that the Group had actually evaded true reforms.

Fraternal Infighting for Corporate Control

The most remarkable event that ridiculed the governmental policies was the struggles for corporate control of the Group between the founder's two scions. The struggles showed that the inheritance of the wealth was the same as before. In addition, there were clearly no improvements in the operation of the board. The board and, notably, the NEDs were actually absent during the conflicts.

The struggles began when the second son, Jung Mong-Koo, removed Lee Ik-Chi, the right-hand man of the fifth son, Jung Mong-Heon, from the chair of Hyundai Securities Co. on March 14, 2000. When removing him, the second son ignored the proper process provided by the *Commercial Law of 1962* and the *Stock Exchange Law of 1968*. He had not received the approval of shareholders and the board, although he changed executives. In addition, he appointed one of his secretaries as the new chair of the company. He intended to gain control over the company where an inheritor had not yet been decided. He thought the company would be indispensable to the auto production affiliates over which he had already gained control. The fifth son, however, thought that the company was his because the Hyundai Commercial Ships Co. was the largest shareholder and he was the largest individual shareholder of the Hyundai Commercial Ships Co. In addition to the two sons, the managers were divided between the two camps, and this aggravated the struggles.⁴⁶⁾

44) KSE, Internal Material (2000).

45) *HanKeoRe*, March 7, 2000.

46) *HanKeoRe*, March 16, 2000; *ChoSunIlBo*, March 26,

Lee Ik-Chi resisted the decision and on March 14, 2000 went abroad to meet the fifth son who had been on a business trip. The fifth son then phoned the Group and suspended the decision. After he returned, the fifth son visited the founder and deprived the second son of co-chairmanship of the Hyundai Group on March 24. In reaction to this, the second son visited the founder on March 25 and reversed the decision, and declared that he had regained the co-chairmanship on March 26. The fifth son then had talks with the founder to reverse what the second son had declared. In reaction, the second son consulted the founder. As the situation became more entangled, the founder declared his preference for the single chair system favored by the fifth son on March 27, 2000 at the Hyundai Presidents Council. The decision on Lee Ik-Chi was also cancelled. The council's decision, however, was prohibited by President Kim Dae-Jung. Additionally, the founder did not have any equity in Hyundai Securities Co and was not a director of the company. In a legal sense, he had no right to intervene in the decision. This series of events was totally outside of the law.⁴⁷⁾ The policies to weaken the chaebol heads were proven completely ineffective.

FINANCIAL DIFFICULTIES AND THE NEGOTIATION WITH THE GOVERNMENT

As it had behaved in this way, the Group lost investors' confidence in the financial markets. After he perceived pressures from the government and financial markets, the second son declared several reform plans on March 31, 2000. First, the Group would immediately dissolve the Hyundai Presidents Council. Second, the family members would not intervene in the management of the affiliates where

they were not registered directors. Third, non-executive directorship would be extended to all the affiliates. Fourth, a personnel sub-committee filled with in the majority with NEDs would be established within the board. Fifth, the Group would prepare an arrangement to activate shareholders' proposals and would regularly disclose management information. He declared, however, that he would retain his position as Group chair. The pro-reformers considered the declaration was no more than a makeshift policy. In particular, they criticized the second son's decision to keep his position as chair of the Group since this meant he would continue to dictatorially govern the Group.⁴⁸⁾

As a result, Hyundai Construction Co. and Hyundai Commercial Ships Co. faced a financial crisis in May 2000. The companies had had to repay US\$602,352,940 between mid-April and mid-May. In addition, the two companies suffered a loss worth US\$376,470,587 from businesses in North Korea because they were the main shareholders of the Hyundai Asan Co., which did its main business in North Korea. The Hyundai Asan Co. had increased its assets from US\$94,117,646 in March 1999 to US\$419,482,352 in May 2000 and most of the money had come from the two companies.⁴⁹⁾ This company, however, suffered huge losses in business related to North Korea.

In return for relief loans of US\$188,235,293 to Hyundai Construction Co. and US\$141,176,470 to Hyundai Commercial Ships Co, the creditors of the two companies demanded: the founder resign all management positions; Hyundai Heavy Industries Co. be separated from the Group during 2000; Lee Ik-Chi, the President of Hyundai Securities Co., and Lee Chang-Sik, the President of Hyundai Investment Trust Co., be removed from their positions.

The family members rejected these demands and

2000.

47) Kim, S. J., 2000: 2.

48) *HanKeoRe*, March 31, 2000.

49) *ChoSunIlBo*, May 26, 2000.

tried to confront the financial crisis, taking the national economy hostage by using its structural and economic power. The founder stepped down from Hyundai Construction Co., Hyundai Heavy Industries Co. and Hyundai Asan Co., but remained as a director of Hyundai Motors Co. He also opposed the demands concerning Lee Ik-Chi. At the annual general meeting on May 27, 2000, Lee Ik-Chi was again appointed president of Hyundai Securities Co. At an instrumental level, the Group continued to try to solve the problems by exploiting its personal links to ruling politicians. At a discursive level, the daily *MunWhallBo* barely made mention of the Hyundai problems but focused on other social problems in order to divert public attention to other topics.

As mentioned above however, the KOSPI plummeted because of the Hyundai problems. Thereupon, the Minister of Finance and Economy convened a Meeting of Economic Ministers and made the chair of the FSC and the president of the Korea Foreign Exchange Bank come to the fore to solve the Hyundai Group problems. On May 28, 2000, the officials of the creditor banks visited the Group and brought messages from the government and creditors. In answer, the Group, however, devised insufficient schemes that did not include solutions to any corporate governance issue. The FSC then directly, not through the banks, applied pressure on the Group on May 29, 2000. The FSC demanded that the Group must present schemes for removing family members and gave a final message that "if the Group did not accept the demands by May 30, 2000, creditors would withdraw all loans."

Finally, on May 31, 2000, the founder declared that he and the second son would step down from management and the fifth son would remain as a director of only Hyundai Asan Co. to conduct North Korea-related businesses. He added that the name of the Hyundai Group would no longer be used and other illegal names such as 'honorary chair' and 'Group chair' would no longer be used as

they previously were, but the share ownership would be maintained as before. In addition, immediately after the declaration, the second son, Jung Mong-Koo, declared that he would continue as chair of Hyundai and Kia Motors Co., and won the confidence of the boards of the two companies. The fifth son also remained as a director in the Hyundai Asan Co. and continued to try to obtain management power in Hyundai and KIA Motors. He regarded the declaration by the founder as a trick by the fifth son, who intended to oust him from auto production companies in an attempt to take them over. In other words, the second son saw the declaration as a continuation of the struggles for corporate control. He stated that the financial crisis of the Group occurred because the fifth son had delayed dividing the Group into several sub-groups. He added that if the fifth son had dissolved the cross share-ownership the group would not have faced financial crisis.⁵⁰⁾

After the declaration, the fifth son retired from his management position in the Hyundai Construction Co. and two professional managers, Kim Yoon-Kyoo and Kim Jae-Soo, ran the company. They did not run the company well, however, because they had risen to top managers through sycophancy to the founder rather than through good performance. The company issued self-reforming plans four times until October 18, 2000. However, the plans were not properly realized; instead the financial status of the company continuously worsened. In particular, the two managers paid more attention to retaining the personal assets of the fifth son than to saving the company, because they were the right-hand men of the fifth son.⁵¹⁾ In addition, the fifth son irresponsibly stayed abroad for one month, even when the company actually went bankrupt. Later, he met the second son and tried to get financial help from Hyundai Motors Co., which the

50) *IYoSinMoon*, June 8, 2000.

51) E-mail from Kwang-Hoe Lee, journalist of *ChoSunIlBo*.

second son governed. The second son did not wish to meet him, however, due to the aftermath of the disputes in March.⁵²⁾ The fifth son revealed that “if the company did not receive financial aid from the government and banks, he would relinquish control over the Hyundai Construction Co.”

As matters had come to this, the government became more anxious about the company than the Group, fearing the unimaginably negative effects of the bankruptcy of the company on the national economy. It hoped the Hyundai Motors Co. would help the Hyundai Construction Co. regardless of the legality of this action. As the second son continued to refuse the request of the fifth son, ministers of the government finally intervened. Lee Keun-Young, the Minister of the FSC, had a one-to-one meeting with the second son in the evening of November 15, 2000. He proposed a compromise that “if Hyundai Motors Co. helped Hyundai Construction Co., the government and banks would also help the Hyundai Construction Co.” In addition, Jin Nyom, the Minister of Finance and Economy, also exerted pressure on the second son to help the fifth son.⁵³⁾

This accomplished nothing more than to utterly overturn the existing government policies on corporate governance reform. The government had implemented policies to weaken the heads and their family members. This compromise, however, meant that the government recognized their management rights and met them as negotiating partners. The government also had forbidden affiliates to help other affiliates through unfair internal transactions and financial aid. Their compromise, however, required an affiliate to help another affiliate. Furthermore, the FTC declared that the help by Hyundai Motors Co. would not transgress the *Law for the Regulation of Monopolies and Fair Trade of 1986*. This attitude was very different from the

existing position. For the government, there were no alternatives because the negative effects on the national economy would be catastrophic. Hyundai Construction Co. had about 3,000 suppliers, was constructing buildings in foreign countries and its collapse would send powerful economic shock waves to financial markets.⁵⁴⁾ This evolution of the struggles and political compromises showed very well the structural power of the Hyundai Group.

COMPARATIVE CHECK ON OTHER CHAEBOL

Based on the above discussions, it follows that the policies to reform corporate governance in the Hyundai Group were ineffective. From this result, it can be logically inferred that the policies were also unsuccessful in other Korean chaebols, because the Group is the prototype of Korean chaebol.

The policies were not a failure in every aspect. There were some visible effective reforms. Most significantly, the current government dissolved the Daewoo Group, formerly the third largest chaebol and braved the negative effect on the national economy. The core affiliate of that chaebol, Daewoo Motors Co., was sold off to General Motors in the summer of 2001 after long negotiations. In addition, the proportion of NEDs on boards notably rose. As seen in Table 5, the four largest chaebols staffed their boards with NEDs in the ratio of at least more than thirty per cent.

Table 5. The Current Status of NEDs

	The No. of listed companies	The ratio of NEDs in boards
Hyundai	16	43%
Samsung	14	34%
LG	12	40%
SK	9	33%

Source: KSE, 2000, Internal Material.

52) *ChoSunIlBo*, November 19, 2000.

53) *HanKeoRe*, November 17, 2000 and E-mail from Young-Shin Yoon, journalist of *ChoSunIlBo*.

54) *ChoSunIlBo*, November 21, 2000.

However, it is doubtful that the policies had any real effect on the chaebol model. Initially, although the Daewoo Group had been dissolved, the four largest chaebols continued their old practices. They completed the inheritance of wealth and management right between generations during the reform period (1998~2001), so younger generations are governing affiliates. The sons are governing core subsidiaries in their chaebol. For instance, Hyundai Motors Co. is managed by the second son of the former head. The only son of the current Samsung head is working as an assistant director for Samsung Electronics Co. The first son of the late SK head manages SK Co. This means that the chaebol utterly ignored governmental policies, which were intended to separate management from ownership. In addition, the NEDs failed to check the heads, because they were usually intimates of the heads. As seen in Table 6, the NEDs were mostly professionals and functioned mainly as advisers rather than supervisors.

Thus, NEDs could not monitor the heads of the chaebol effectively. Rather, stakeholders such as the representatives of employees would have properly kept them in check. The advocates of the non-executive directorship had to take into account the particular politico-social contexts to Korea when they introduced the institution to Korea. In the U.S.A. and the U.K., NEDs are the agents of shareholders and supervise the executives. In contrast, the main shareholders are executives and small shareholders are powerless in Korean chaebols. Therefore, it is innately difficult for non-

executive directors as the agents of small shareholders to supervise powerful owner-executives. In addition, other institutional structures such as ownership and financial structures, which are knit with corporate governance, remain intact. As a result, the heads have maintained their governing power through mutual ownership and mutual debt-guarantee among affiliates. Without concomitant reforms in surrounding institutional structures, it is very difficult to reform corporate governance significantly.

Furthermore, the current government and the ruling party are going to deregulate the existing ceiling of mutual ownership during the regular session of the National Assembly in 2001. The anti-reformers such as the opposition party and the chaebol have argued that the reforms introduced by the current government caused economic recession. The discursive power of the anti-reformers is so strong that the government would change its policy line towards deregulation. The structural and discursive power is effective in blunting the reform advocates.

CONCLUSIONS

Based on the above discussions, this article draws two conclusions. First, despite punctuated change, the degree of institutional change i.e., corporate governance reform, was gradual and piecemeal. According to Krasner's theory of punctuated equilibrium, Korea would have experienced radical changes because the chaebol model had not

Table 6. The Background of NEDs

	Hyundai	Samsung	LG	SK	Total (%)
Professor	15	17	10	9	40.8
Lawyer	3	4	2	4	15.2
CPA	2	0	0	1	3.2
Foreigner	0	4	0	0	3.2
The rest*	9	14	12	4	37.6

* Former higher government officials and politicians are categorized to the rest. These people act as lobbyists for chaebols. Source: adapted from *JoongAngIlBo*, August 29, 1999, p. 29.

displayed any significant changes in the 37 years since 1961 until it collapsed abruptly late in 1997. Yet, the reality belied Krasner's theory; rather it supported gradual change perspective raised by North and Skowronek. The government's policies to reform corporate governance were clearly ineffective. Although there were some apparent changes, such as the increase of the proportion of NEDs on boards, the policies could not significantly weaken the power of the chaebol heads and their family members.

Second, the gradual reform was a product of politics rather than economic evolution. The results reflected the political struggles and compromises between pro-reformers and the chaebol. The chaebol resisted government policies by depending on instrumental, structural and discursive power. In particular, the Hyundai Group drew on financial aids in compromise with the government by holding the national economy hostage by exploiting their structural power. Therefore, the changes in economic institutions cannot be fully explained only by the logic of market-driven efficiency. According to the law of market, the chaebol model would no longer be a proper vehicle for Korean corporations. Due to political factors however, it has survived.

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