

-Corporate Governance - Regulatory Perspectives in the case of Korea

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Jisoo Lee, Esq.

Center for Good Corporate Governance.



Highly Concentrated Economic Power of Chaebols

- *Definition of Chaebol or Chaebol Group*

- Korean term for a conglomerate of many companies clustered around one parent company.
- Four Super Chaebols : Samsung, LG, SK, Hyundai Motor

- *Characteristics*

- Conglomerates of many companies
- Hold shares in each other (in the name of ‘affiliated companies or *kaeyeolsa*’)
- Normally run by one individual or one family (founding family)
- Amazing concentration of economic power
 - Top four Chaebols - 48% of the entire stock market (KSE)
 - Top four Chaebols' revenue – account 30% of the entire GDP (2002)
 - Only account for less than 5% of the entire employment in Korea
- Spread across industries
- Centralized decision-making process

Economic Concentration

- Market Capitalization of Top 4 Chaebols -

As of 2002

(Unit: 100 million won, %)

Name	Listed Affiliates	Market Capitalization	%
Samsung Group	14	701,742	26.8
LG Group	12	183,484	7.0
SK Group	11	242,690	9.3
Hyundai Motor Group	6	135,362	5.2
Sub-total	43	1,281,650	48.3
Total Listed Corporations	683	2,618,571	100.0

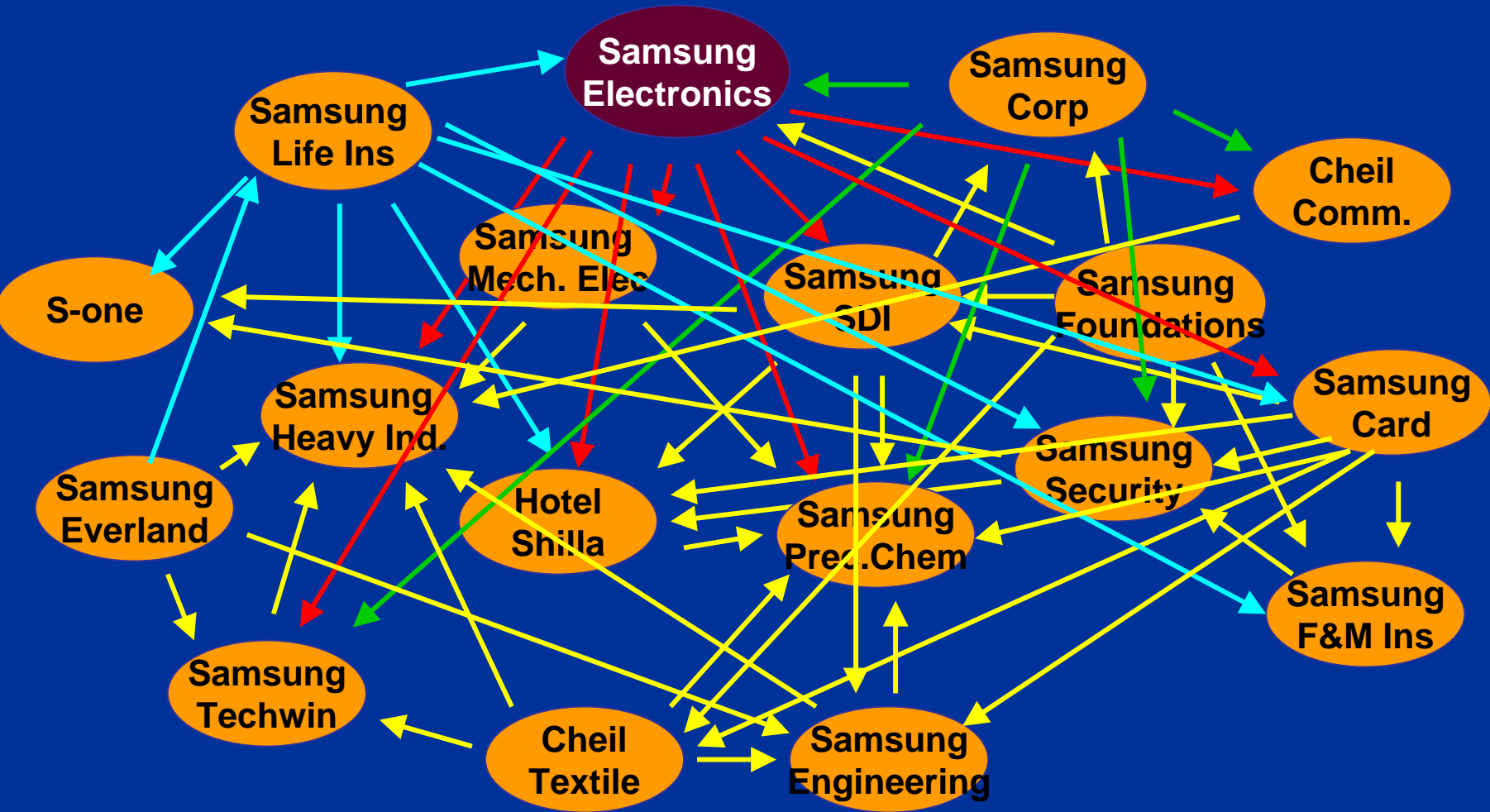
Source of Power

- Shareholding Structure of Top 4 Chaebols -

(Unit: %)

	Controlling Shareholders	Affiliated Companies	Treasury Stock	Total
1997	7.41	26.86	1.80	37.42
1998	6.75	32.26	2.18	41.88
1999	4.64	24.79	2.09	32.28
2000	3.87	27.59	5.47	37.90
2001	4.57	27.61	4.00	37.26
2002	5.46	27.20	4.27	37.94
2003	5.08	26.78	4.24	36.99

Pyramidal Equity Ownership: Samsung Group



The Role of Korean Government since 1997

“5 + 3” Corporate Reform Principles after the Economic Crisis

- **Five Principle Policies (Feb. 1998)**
 - Improving financial structure (reduction of debt)
 - Building competitiveness for chaebol groups
 - Enhancing transparency
 - Removing cross-debt guarantee
 - Enhancing accountability of the controlling shareholder & management
- **Three Additional Principles (Aug. 1999)**
 - Reducing circular equity ownership and unfair transaction among affiliated companies
 - Improving corporate governance of non-bank financial institutions
 - Strengthening tax system

New Regulations Introduced by Korean Government

- **Mandatory Outside Directorship**
 - Required for all listed companies of KSE & KOSDAQ
 - More than 25% of the board should be the outside director
 - For company with assets larger than 2 trillion won (\$1.7bil), more than 50% of the board should be the outside director
- **Outside Director Recommendation Committee**
 - Mandatory for company with assets larger than 2 trillion won
 - More than 1/2 of the Committee must be consisted with the outside directors
- **Reformed Accounting Standards**
 - Introduction of Global Standards
 - Mandatory report of Combined Financial Statements

New Regulations Introduced by Korean Government (cont'd)

- **Restrictions on Total Amount of Shareholdings on Other companies**
 - No more than 25% of its net asset value
 - Applies to chaebol groups with asset greater than 5 trillion won (\$4.2 billion)
- **Stringent Regulations on Related Party Transactions**
 - Related party transactions greater than \$8.3 million
 - Board's prior approval
 - Immediate disclosure
 - Applies to chaebol groups with asset greater than 5 trillion won (\$4.2 billion)

New Regulations Introduced by Korean Government (cont'd)

- Transformation into a Holding Company System
 - Recommended formation by the government
 - Holding company's debt-to-equity ratio should be less than 100%
- Cumulative Voting in Election of Directors
 - Opt-out system
- Heightened Responsibility of the Shareholder
 - Fiduciary duty of directors
 - Liability of shadow director (controlling shareholder who does not seat on the board)
- Strengthened Minority Shareholders Right

New Regulation Introduced by President Roh's Administration

- **Securities-related Class Action Lawsuit**
 - Grounds: stock price manipulation, misrepresentation, false disclosure, accounting manipulation and failed audit
 - Listed corporations with larger than 2 trillion total assets → Jan. 2005
 - All other listed corporations → Jan. 2007
 - Advocated 'Three-year Roadmap' regarding the reform
- **Three Year Roadmap**
 - Regulation against Chaebols
- **Separation of Financial Institutions from Industrial Company (Chaebol group) - pending**
- **Strengthened taxation system**

Positive Changes in Corporate Governance

- Increased awareness on corporate governance
- Disclosures are more reliable
- Related party transactions decreased
- Investor relation is more active than ever
- New court rulings sets the standard
 - Derivative lawsuit:
 - Korea First Bank: \$33.3 million
 - Samsung Electronics Co.: KRW 20 billion (US\$17 million)
 - Court ruling against “lack of business judgment”

Persistent Problems in Corporate Governance

- Old habits are hardly changing
 - Mindset of controlling family is the same, persistent moral hazard, on-going suspicious transactions
- Resistance from the establishments
 - Close relationship with the conservative political party
- ‘Independence’ of outside directors in question
- Expropriation of the minority shareholders
 - Discounted CBs, BWs
 - Management control descended to the 3rd Generation
 - Off-shore paper company operation
- Entrenched ownership structure
 - Control via ownership by affiliated companies

Shareholder Activism in Korea

- People's Solidarity for Participatory Democracy -
(‘PSPD’)

Shareholder Activism in Korea

- Started since Jan. 1997
- PSPD (People's Solidarity for Participatory Democracy)
 - Independent civil rights advocate group (NGO)
 - Founded in 1994
 - Nine centers, four committees, four research institutions and various other organs
 - Funded by private donation
 - About 15,000 members
- PEC (Participatory Economy Committee)
 - One of the action centers of PSPD
 - Focus on economic reforms
 - Lawyers, CPAs, Professors (20 active members)
 - Volunteer services

Shareholder Activism in Korea (cont'd)

- ***Objectives of PEC***

- Economic reform through corporate reform
- Value creation through better corporate governance
- Protection of the minority shareholder's right
- Corporate watchdog
- Activism focused on 'chaebol' companies
- Monitoring banks and financial institutions

- ***Target companies***

- | | |
|--------------------------|---------|
| - Samsung Electronics | Samsung |
| - SK Telecom | SK |
| - Hyundai Heavy Industry | Hyundai |

Shareholder Activism in Korea (cont'd)

- *Activities*

- **Constructive Talk with the Management**

- **Shareholder' Campaign**

- Attending shareholders meeting and raise questions
- Proxy fight for certain agenda
- Election/Recommendation of the independent outside directors ex.) SK Telecom, Hyundai Heavy Industries
- Submitting shareholder proposal and etc.
- Inspecting financial books and records

- **Monitor Corporate Actions**

- Corporate disclosures
- Related party transaction
- Board activities ex.) attendance rate, tracking votes
- Financial Statements

Shareholder Activism in Korea (cont'd)

- **Legal Suits**
 - Derivative suits
 - \$36 million against Directors of Korea First bank
 - \$350 million against Chairman Lee of Samsung Group
 - Suits to nullify pre-issued CBs and BWs
 - Legal actions against the external auditing firms
- **Petition the Legislature**
 - Securities-related Class Action Lawsuits
- **Hold hearings, conferences and etc.**
 - Monopoly Regulations & Fair Trade Act
 - Securities & Exchange Act
- **Advocate Corporate Reform**
 - Using various media (newspaper, Internet, TV and etc.)
 - Lobbying

PSPD's Accomplishments in 2003

- **Enacted Securities-related Class Action Lawsuits**
- **Derivative suit against Samsung Electronics:**
 - Chairman Kun-Hee Lee & 10 current and former directors
 - The Appellate Court held directors were liable for 20 billion won
- **Civil Lawsuit against Hyundai Group regarding Hynix**
 - Price fixing
 - PSPD prevailed at the Appellate level, the final decision pending
- **Cancellation of BWs**
 - Hyundai Industrial Development, Hyosung, Tong Yang

PSPD's Accomplishments in 2004

- **Samsung Electronics' annual shareholders meeting**
 - Raised the minority shareholders' voice regarding illegal funding and unfair trading
 - Filed a legal action to nullify the resolutions passed at AGM
 - Tort action pending
- **Shareholder Proposal against SK Telecom**
 - Recommendation of resignation of corrupted directors who were both convicted
 - The two-convicts finally resign from their posts at AGM
- **Derivative suit against SK Corp. & SK Shipping**
 - Pending and gathering proxies (1%)
- **Legislative campaign**
 - Act on PEF (Private Equity Fund)
 - Financial Holding Company Act