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Korea's Capital Market Promotion Policies: IPOs and Other Supplementary Policy Experiences[†]

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This paper studies a series of capital market promotion policies Korea pursued over a 30-year period during its development era (1960s – 1980s). The purpose of this paper is twofold. The first purpose is to understand the policy approaches Korea took, and the second is to extract lessons that can benefit policymakers in the developing world, where capital market promotion is an important policy goal. There are two key features of Korea's capital market promotion policies. First, the government was actively involved, sometimes indirectly by giving tax incentives to encourage IPOs. However, in other times, it was directly involved by giving IPO orders and threatening those that did not comply. No stock exchange in a developed country has ever experienced such government involvement. Combined with rapid economic growth, this interventionist approached allowed the Korean stock market to experience phenomenal growth over a short period of time. Second, the capital market promotion policies had multiple objectives. One was to mobilize domestic capital for economic development. Another was to lower firms' debt-to-equity ratios. Most interestingly, however, the Korean government wanted to popularize stock ownership, thereby allowing ordinary Koreans to share in the fruits of economic growth.

Key Word: Capital market promotion, initial public offering, securities deposit and settlement systems, employee stock ownership plan, Korea
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I. Introduction

It is a great challenge for less developed countries to create a strong securities market. They lack many of the institutions that control information asymmetry and self-dealing. That is, legal and market institutions that ensure that minority shareholders (i) receive good information about the value of a company's business and (ii) allow them to have trust and confidence in a company's management and controlling shareholders. Regulators, prosecutors, and courts may not be honest or sophisticated enough to carry out this task. Accounting and financial disclosure rules may not be comprehensive or independently audited. Reputational intermediaries, such as investment bankers, accountants, and securities lawyers, may not be sophisticated enough nor subject to liability risk (Black 2001).

When the Daehan Stock Exchange was established in February 1956, none of the necessary legal and market institutions were present. At the time, the market was akin to a legalized gambling casino, often plagued with speculative bubbles and bursts. With a limited score of listed firms, the size of the primary market was very small. It hardly served as a channel through which firms raised external equity capital. In contrast, there was an enormous secondary market. The percentage of stock trading, which was marginal in the 1950s, had suddenly surpassed that of government bonds by 1961. This was, however, attributable to a high volume of speculative transactions. Because speculators made use of clearing transactions, which is similar to today's futures transactions, the trading volume often soared to unsustainable levels. On a number of occasions, this caused the Korean government to step in and rescue a stock exchange at the brink of a massive default.

By 2010, however, the market capitalization of the Korea Exchange (KRX) was 1.1 trillion USD. This ranks the KRX as the 17th largest stock exchange in the world, in terms of equity market capitalization (World Federation of Exchanges). What explains this astonishing achievement over a 50-year period? This paper is seeks to answer this question in part.

This paper investigates series of capital market promotion policies Korea pursued over a 30-year period during its development era (1960s – 1980s). The purpose is to extract lessons that can benefit policymakers in the developing world, where capital market promotion is an important policy goal. Given that the Korean government's main interest was to mobilize domestic capital for economic development and to lower the debt-to-equity ratio of firms, I have left out the bond market from my analyses, and when discussing the stock market, I have put greater emphasis on its primary market policies than on its secondary market policies

The paper is composed of two parts: primary market policies (Chapter 2) and other supplementary policies (Chapter 3). The latter includes secondary market policies (Sections 1 and 2) and policy measures taken to expand the stock market's investor base (Sections 3). They are both supplementary to the primary market policies for obvious reasons. First, no country can have a vibrant primary market without a well-functioning secondary market, where share prices are set efficiently and shares are traded with reasonably low transaction costs. It is also obvious that the primary market cannot be enlarged by simply increasing the supply of shares. Instead, there should be a commensurate increase in the investor base of the stock market.

During its development era, the mobilization of domestic capital was not the sole objective of the Korean government's capital market promotion policies. Throughout this period, policymakers emphasized that IPOs can be used as a means by which the country could share in the fruits of its economic growth. This policy stance emerged repeatedly under many different names, such as the popularization of stock ownership, the democratization of stock ownership, and the socialization of corporate ownership.

With regard to primary market policies, I cover the initial public offering (IPO) inducement measures taken during 1968-71 (Chapter 2, Section 1), the coercive IPO orders implemented during 1972-78 (Chapter 2, Section 2), and the promotion of IPOs and Seasoned Equity Offerings (SEO) in the late 1980s (Chapter 2, Section 3).

On secondary market policies, I cover the adoption of a regular transaction system in 1969 and the subsequent measure taken on June 3, 1971 (the 6.3 Measure) (Chapter 3, Section 1). I also cover a number of securities deposit and settlement systems that have been introduced since 1973.

Last but not least, I cover policy measures taken to expand the stock market's investor base. Specifically, I analyze the employee stock ownership plan (ESOP), introduced in 1968 and reinforced in 1974 (Chapter 3, Section 3). For each policy measure, I discuss its background and detailed contents, and I present its outcome and evaluation.

II. The Primary Market Policies

A. *The Initial Public Offering Inducement Measures (1968-1971)*

1. *Background*

Three points are important to note as the background surrounding the IPO inducement measures that were taken in 1968. First, firms grew rapidly during the period of the First Five-Year Economic Development Plan (1962-1966), but they also experienced a significant deterioration of their debt-to-equity ratios. Second, in order to finance the Second Five-Year Economic Development Plan (1967-1971) successfully, there was a compelling need to mobilize domestic capital from the stock market (Shin 1987). However, the stock market had been in a dismal state since a bubble burst in 1962, and it did not function well as a source for equity capital. Third, as a means of raising domestic capital, the government was planning to sell its shares in state-owned enterprises. By doing so, the government hoped to sell its shares to the general public, thereby popularizing stock ownership throughout the country.

Table 1 shows the external financing structure of Korean firms from 1963 to 1968. One notable observation is that the total amount of externally raised capital increased nearly tenfold during this five-year period, from 36.2 to 321.8 billion won. Another observation is that they were mostly raised either from foreign debt sources or from bank lending sources. Note that the figures under Others are mostly private loans. Also note that the proportion of equity financing drops from 25 percent in 1963 to 12 percent in 1966. In the following year, it would drop further to 8 percent.

TABLE 1—THE EXTERNAL FINANCING STRUCTURE OF KOREAN FIRMS, 1963-1968

(UNIT: billions of won, %)

Year	External Financing	Debt Capital				Equity Capital	
		Total	Foreign Debt	Bank Loans	Others	Amount	Percentage
1963	36.2	27.1	8.3	6.4	12.4	9.0	25
1964	26.9	19.8	2.7	6.4	10.7	7.2	27
1965	48.4	39.0	4.7	11.5	22.8	9.4	19
1966	107.9	95.0	48.8	10.4	35.8	12.9	12
1967	198.7	182.7	64.6	62.0	56.1	16.0	8
1968	321.8	296.7	108.7	107.8	80.2	25.1	8

Source: ECOS, Bank of Korea.

TABLE 2—CAPITAL STRUCTURE OF MANUFACTURING FIRMS, 1963-1968

(UNIT: %)

Year	Debt-to-Equity	Equity-to-Asset	Interest Coverage	Interest-to-Sales
1963	92.20	52.03	405.56	3.02
1964	84.98	54.06	273.66	4.89
1965	82.51	54.79	320.86	3.91
1966	106.15	48.51	236.87	5.65
1967	127.75	43.91	227.21	5.19
1968	167.37	37.40	212.65	5.90

Notes: Interest coverage ratio refers to EBIT/(interest payments).

Source: ECOS, Bank of Korea.

TABLE 3—STOCK MARKET STATISTICS, 1963-1966

(UNIT: millions of won, %)

	1963	1964	1965	1966
No. of Listed Firms	15	17	17	24
Paid-in Capital Increase	608	369	100	369
Trading Volume	26,000	27,039	9,271	11,160
Modified Average Stock Price Index	57.27	62.47	60.94	62.87
Producers' Price Index (PPI)	46.30	62.30	68.50	74.40

Notes: Modified Average Stock Price Index (1972 = 100), PPI (1970 = 100).

Source: Rhee *et al.* (2005) and Hong (2005).

Original Source: Securities Market Yearly Statistics.

With a greater reliance on debt financing, the debt-to-equity ratio deteriorated rapidly for many of these companies. Table 2 illustrates the capital structure of manufacturing firms during the same time period. One can easily see that the debt-to-equity and interest-to-sales ratios increased, while the equity-to-asset and interest coverage ratios dropped.

Table 3 shows stock market statistics from 1963 to 1966. Although the number of listed firms increased slightly during this period, the number of new equity offerings and the trading volume both dropped. The stock market index increased as well, but its growth rate was well below that of the producer's price index (PPI).[1] Moreover, a high bank deposit rate of around 30 percent discouraged people from investing in the

[1]Stock market index refers to the Combined (12 issues) Index (1972=100).

stock market (Hong 1973). Also, as of 1966, most listed firms were state-owned enterprises. There were only six firms which were not.

In the second half of 1962, making stock ownership more popular emerged as a major policy objective. It served as a way to normalize the stock market, the reputation of which was significantly tarnished after the bubble burst in 1962. It was also influenced by the Japanese experience after World War II (Kyunghyang Shinmun 1962. 9. 5). When the Zaibatsu – Japanese family-controlled business groups – were dissolved during America's occupation of Japan, a significant number of shares, originally held by the family members, were sold to company employees. This greatly helped to popularize stock ownership in Japan. It also changed the perception the Japanese had towards the stock market. No longer was the stock market perceived to be a place for gambling. It was instead seen as a market where firms could raise long-term capital, as well as a place where people could invest their savings.

2. *The Legislative Process*

The effort to enact laws to encourage the development of the capital market started with the National Assembly. Mr. Nam-June Lee and 52 other National Assemblymen submitted a bill entitled the Stock Investment Security Act in January of 1965. Although the bill did not pass the National Assembly, it triggered other similar bills (Rhee *et al*. 2005). Eventually, on September 9, 1968, the Finance and Economy Committee – a standing committee of the National Assembly – proposed the Capital Market Development Act.

The Capital Market Development Act passed the National Assembly on November 8, 1968 and was enacted, promulgated, and took effect on November 22, 1968. This Act, together with the Securities Exchange Act, constituted the two pillars of Korea's securities market regulation: one for the primary market, and the other for the secondary market. In order to lower corporate income tax rates for those public firms subjected to these laws, Mr. Lee also submitted a bill to revise the Regulation Law on Tax Reduction and Exemption in July of 1968. This law also passed the National Assembly on November 8, 1968.

The Ministry of Finance (Minister Bong-Kyun Seo) also echoed Mr. Lee's arguments in July of 1967, by announcing the Capital Market Development Plan, which promised the sale of state-owned enterprises to the general public, as a way to raise government revenue and popularize stock ownership (DongA Daily Newspaper 1967. 7. 15). However, contrary to its original plan, the state-owned enterprises were sold to Chaebols – family-controlled Korean business groups – at bargain prices.

Although it was claimed that privatization was enacted for the general public, its laws failed to spark public interest in a meaningful way. Article 4 in the original bill provided that, for employees of central/local governments and state-owned enterprises, bonuses, pensions, severance pays, and compensations would be paid in securities owned by the government. This triggered strong resistance from labor unions. The Federation of Korean Trade Union saw the provision as an infringement of property rights and resolved to strike as a means of protesting the new bill (DongA Newspaper 1968. 7. 1). Such movements led the National Assembly to revise the bill such that government-owned securities would be used as a means of payment only when specifically requested by the employee (DongA Newspaper 1968. 7. 4). Nonetheless, even this revision proved unsatisfactory to labor unions. As a result, Article 4 was removed in its entirety from the bill.

3. *The Details and Implementations of the Act*

Article 1 listed the Act's objectives, which included the promotion of IPOs, the greater dispersion of share ownership, people's ownership of firm shares, greater reliance on equity financing, and ultimately the development of a sound capital market. Chapter 2 of the Act covered measures to encourage dispersed share ownership and stock investment. Chapter 3 covered provisions on IPOs and Chapter 4 included provisions on the establishment of the Korea Investment Development Corporation.

3.1 Dispersed Share Ownership and Stock Investment

First, to encourage people to participate in stock ownerships, the Act guaranteed minimum dividend yields. If dividends fell short of the level established in the Enforcement Decree (i.e., 10 percent), nongovernment shareholders would have priority in receiving dividends, until their yields reached the guaranteed level. To enable this, the Act allowed firms to adjust the dividends distributed to government shareholders. Second, the Act allowed shares to be used for paying security deposits. Government and state-owned enterprises were not allowed to refuse such deposit payments.

Third, for shares held either by the government or by the Korea Development Bank (KDB), the Act allowed discounted share offerings when selling shares to the general public, civil servants, or to state-owned enterprise (SOE) employees. Such shares were subject to a mandatory holding period specified in the Enforcement Degree (i.e., until the day of the next annual shareholders' meeting). This measure obviously aimed to encourage dispersed share ownership, and was at least partly influenced by the criticism raised against the first-price auction when privatizing SOEs (Rhee *et al*. 2005). Most SOE privatizations under the first-price auction resulted in Chaebols acquiring significant ownership.

Fourth, as another method to encourage dispersed share ownership of listed firms (or non-listed public firms), the Act also allowed share offerings to company employees, with an exception to the preemptive rights of existing shareholders.[2] The fraction of such shares, however, could not be more than 10 percent of outstanding shares. Fifth, the Act exempted the income tax on dividends.

[2]The term "public firm" is defined in the Corporate Income Tax Code (Article 22-3). According to the Code, a public firm is a listed firm or a non-listed firm that meets the following three conditions. First, the percentage of holdings by minority owners (shareholders individually holdings less than 3 percent of outstanding shares) must be at least 20 percent of outstanding shares. Second, the number of minority shareholders must be at least 30. Third, the fraction of holdings by any shareholder, together with his or her relatives defined in the Enforcement Decree, must be no more than 60 percent of outstanding shares.

3.2 Initial Public Offerings

To encourage firms to go public, the Act gave tax and special depreciation benefits to listed firms (or non-listed public firms). Table 4 summarizes the corporate income tax rates applicable to public and nonpublic firms. In the highest income bracket, the two tax rates differ by 20 percentage points. With regard to depreciation, the Act permitted an extra 20 percent depreciation for listed (or non-listed public) firms.

TABLE 4—CORPORATE INCOME TAX RATES (PUBLIC VERSUS NON-PUBLIC)

Income Ranges	Public Firms	Non-public Firms
Below 1 million won	15%	25%
Between 1 and 5 million won	20%	35%
Above 5 million won	25%	45%

Source: Rhee *et al.* (2005).

Some individuals, however, raised concerns that the number of corporate blackmailers would increase with a greater number of minority shareholders.[3] This led the Act to permit the chair of shareholders' meeting to have the authority to preserve and maintain order. This meant that the chair would be able to stop any person from speaking, or order him removed, if the chair were to judge that the person is intentionally disturbing the orderliness of the meeting.

3.3 Korea Investment Development Corporation

The Act established the Korea Investment Development Corporation (KIDC), to underwrite newly offered shares, promote dispersed share ownership, and stabilize share prices.[4] Legally, the Corporation was a stock company, in which the government owned 50 percent of outstanding shares. Under its shareholders meeting, it had an Investment Review Committee that screened new offerings, underwrote government-owned shares, and set offering prices.

The Act regarded the KIDC as a securities company and required it to be registered as one. The Act also permitted KIDC a wide scope of businesses: (i) securities underwriting, (ii) securities trading, (iii) public offerings and sales arrangements, (iv) stock price stabilization, (v) sales of government- or SOE-owned securities, (vi) research and advisory services to issuing firms, (vii) securities collateral loan business, and (viii) securities investment trust business.

It is also important to note that the KIDC had the potential to mitigate the information asymmetry problem in the primary market. As a securities underwriter and agent with a mandate to stabilize newly offered shares, it had the potential to serve as a reputational intermediary.

[3]Corporate blackmailers are unique to Korea and Japan. They usually extort money from or blackmail companies by threatening to publicly humiliate companies and their management.

[4]In December 1972, the Korea Investment Development Corporation (KIDC) was renamed as the Korea Investment Corporation (KIC). The Korea Investment Corporation was established in July of 2005 as a sovereign wealth fund, and is not related to the KIDC established in December of 1968.

4. *Outcomes and Evaluation*

The KIDC was launched in December of 1968 with a paid-in equity capital of 1.5 billion won (authorized capital of 3 billion won). Shareholders include the government (500 million won), the KDB (5 million won), and other private sector participants (5 million won). Byung-June Lee was appointed as the KIDC's first President. To convey the government's strong determination to the public, it even named 1969 the "Year of Capital Market Development" and May 3rd as "Securities Day."

Despite such initial enthusiasm, the outcome was disappointing. From Table 5, one can observe that, between 1968 and 1971, market capitalization, the capital stock of listed firms, the number of listed firms, the increase in the paid-in capital, and the number of shareholders all increased, giving an impression that the government made some progress. However, the reality behind the figures was far different. First, most of the newly offered shares were acquired by banks. As a result, bank lending was merely replaced by bank equity investments, thereby perpetuating the same reliance on banks as before. Second, the firms that went public according to the definition set out in the Corporate Income Tax Code refused to be listed on the stock market. Note that the tax code did not distinguish between non-listed public firms and listed public firms when granting tax benefits, which led them to remain non-listed (Kyunghyang Shinmun 1970. 5. 2).

Third, the fraction of shares owned by small-scale investors (those holding less than 1,000 shares) increased only by 0.8 percentage points over a four-year period, suggesting that the government had failed to achieve its goal of promoting dispersed ownership. Not surprisingly, the amount of public offerings was also a merely 5.29 billion won. Fourth, there were disguised public offerings during this period. In order to meet the conditions as a public firm, controlling shareholders of two different firms mutually exchanged their shares. By periodically trading the shares, they were even able to satisfy the requirements of a listed firm (Maeil Business Newspaper 1970. 10. 15). As shown in Table 5, the trading volume was insubstantial. In 1971, the total number of shares traded accounted for only 30 percent of shares outstanding.

TABLE 5—STOCK MARKET STATISTICS, 1968-1971

	Unit	1968	1969	1970	1971
Market Capitalization	Million won	64,323	86,569	97,922	108,706
Capital Stock Listed	Million won	96,585	119,902	134,292	141,356
No. of Listed Firms	New	10	8	6	2
	Cumulative	34	42	48	50
Paid-in Capital Increase	No. of Firms	10	6	13	7
	Million won	20,317	5,983	6,225	2,090
Public Offerings	No. of Firms	2	12	9	4
	Million won	160	2,211	2,068	850
No. of Shareholders	-	39,986	54,318	76,276	81,923
Share Ownership by Small-scale Investors	%	2.03	1.91	2.74	2.83
Yearly Turnover	Yearly	0.67	0.70	0.49	0.29

Notes: Small-scale investors refer to those holding less than 1,000 shares. Yearly turnover is measured as follows: (total number of shares traded per year / total number of shares outstanding at year-end).

Source: Securities Market Yearly Statistics, 1972.

Such failure was predicted from the beginning (Kyunghyang Shinmun 1968. 11. 12), given that stock returns were well below bank deposit rates, and because high inflation rates discouraged the general public from investing in the stock market. Experts at the time predicted that the public would instead invest in the real estate market. The 10 percent dividend yield guaranteed by statute was also judged to be too low by experts. The level may have been sufficient for the controlling shareholders to produce a healthy return on their investments, but it was insufficient for outside minority shareholders.

Overall, the government's IPO inducement policy of 1968 failed to achieve its policy goals. Nevertheless, it contributed to the Korean capital market in two ways. First, it greatly dissipated the stigma of the stock market as a place for gambling. Second, it created KIDC, which would later play an important role in developing the Korean capital market.[5]

B. *The IPO Promotion Act: A Coercive Approach (1972-1978)*

1. *Background*

The Economic boom in the second half of the 1960s spread optimism among the Korean business community. The boom encouraged large Korean firms to increase their bank borrowings. Borrowing from banks, however, was not enough. To expand their businesses, these companies began to finance their activities through private loans. However, this strategy proved to be a mistake. The monthly interest rates on these private loans were very high, about 5 percent on average. Some loans were as high as 10 percent per month (Koh 2008). By 1972, many firms could no longer service their debts. The Federation of Korean Industries (FKI) asked the government to take an emergency action. The government intervened, as requested. On August 3, 1972, the government announced that it would freeze all the existing private loans to businesses, and later restructured their terms, which were greatly in favor of the borrowers.

Policymakers who were involved in this Emergency Measure of August 8, 1972 opined that Korean firms should make definitive changes to their capital structures.[6] As a direct result, the necessity to promote public offerings received renewed interest in Korea. Public offerings were also perceived as a way to *socialize* corporate ownership in Korea (Kim 2006). The failure of the IPO inducement policy in 1968, however, led policymakers to establish a more coercive approach. Undoubtedly, the political environment under the *Yushin* Regime made such a coercive approach possible.[7]

[5]Korea Investment Development Corporation (KIDC) was the first institution that sold investment trust certificates (May 1970). When it was dissolved in 1977, its role and staff were transferred to the Securities Supervisory Board and Daehan Investment Trust Company.

[6]For details on the Emergency Measure of August 8, 1972, see Kim (2002). The paper argues that the new IPO promotion policies were already conceived when preparing for the private debt freeze measure.

[7]In October of 1972, after declaring a state of emergency, President Park dissolved the National Assembly and suspended the constitution. Soon the constitution was revised in a way that paved the way for President Park to take authoritarian and lifetime power without any limits on his power. This new regime is referred to as the Yushin

The much lower interest rates set after the Emergency Measure of August 8 created an environment conducive to pursue an IPO promotion policy. Relatively high stock returns also attracted people to the stock market. This renewed interest in stock investments and the initial increase in the number of IPOs, however, were temporarily interrupted by the oil shock in late 1973.

2. *The Details of the Act*

By the time the Emergency Measure of August 8 was fully implemented, the Ministry of Finance (Minister Duk-Woo Nam) finished its preparation of the bill which would become the IPO Promotion Act.[8] The Act was approved by the Emergency State Council on December 30, 1972 and came into effect on January 5, 1973. The objectives set out in Article 1 of the Act were very similar to those written in the Capital Market Development Act. The Act aimed to promote IPOs, facilitate equity financing, improve the capital structure of firms, promote people's ownership of stocks, and contribute to the nation's economic development (Nam 2009).

Although the two Acts were similar in terms of their main objectives, the approaches taken to execute them were very different. The Capital Market Development Act of 1968 took a passive approach, aimed at inducing voluntary IPOs through tax incentives. In contrast, the approach taken in the IPO Promotion Act of 1972 was a coercive one, relying on government orders and penalties. Firms were unilaterally designated by the government to go public; if they did not comply, the government had the authority to penalize them by restricting bank lending. Such a coercive approach was only possible due to the new political environment under the Yushin Regime.

2.1 IPO Review Committee

The Act established the IPO Review Committee that would deliberate on and finalize policies necessary to implement the Act (Article 3). The committee was composed of 8 to 11 members. The *ex officio* members included the Prime Minister (who presided over the meetings), the Minister of Economic Planning Board (EPB), the Minister of Finance, the Minister of Industry and Trade, the Governor of the Bank of Korea, the President of the KIDC, and the President of the Korea Stock Exchange. In addition to these *ex officio* members, one to five civilians with knowledge and experience in securities matters were appointed as members by the President.[9]

Regime. The word Yushin is the Korean pronunciation of the Japanese word Ishin, which means restoration. Ishin is used in Meiji Ishin, which refers to the chain of events that restored imperial rule to Japan in 1868.

[8]In September of 1971, the Ministry of Finance established a new bureau exclusively for securities and insurance affairs. Mr. In-Kie Hong was appointed as the first Director-General of this bureau (September 1971 – August 1973). Mr. Hong was succeeded by Mr. Lee, Kun-Joong (August 1973 – May 1976).

[9]According to Byung-Woo Koh, individual IPOs were authorized by the Assistant Minister of Financial Affairs at the Ministry of Finance. Mr. Koh served as the Assistant Minister of Financial Affairs from January of 1975 to September of 1977.

2.2 Designation of Qualified Firms

According to the Act, the Ministry of Finance reviewed a set of firms (known as target firms) and designated a subset (qualified firms) that would be given order by the Minister of Finance to go public (Article 4). Target firms included (i) firms that were approved under the Foreign Capital Inducement Act to receive foreign loans or import capital goods in excess of their capital (1 billion won, if capital is greater than 1 billion won), (ii) firms that had borrowed from domestic financial institutions in amount more than 1 billion won, and (iii) firms which needed to become a public entity for the sake of Korea's economic development.

Qualified firms were those that met the following conditions: (i) equity capital in excess of 50 million won, (ii) two or more years of operation since establishment, (iii) dividend yields expected to be greater than 10 percent after an IPO, and (iv) shares expected to trade above par value. When giving IPO orders, it was also required that the Minister of Finance give instructions concerning the details of the offering. These details included (i) the number of shares that needed to be publically offered, (ii) upper ownership limit per shareholder (including related parties), (iii) offering terms, and (iv) the offering deadline. The Act set the upper ceiling of 51 percent as the restriction on ownership per shareholder.[10] The Act could have set the upper limit to a lower amount, but concerns by company owners over losing corporate control resulted in the government setting it to slightly above 50 percent.

To facilitate government's document review, the Act gave Minister of Finance the power to request necessary information from subject firms, and to inspect their financial statements (Article 6). The Minister of Finance also had the authority to ask for cooperation from government agencies and other related organizations. These agencies and organizations had to oblige unless there was a clear reason not to (Article 7).

To facilitate public offerings and achieve dispersed share ownership, the Act required the establishment of an organization that would act as a stand-by underwriter, and purchase unsubscribed shares, later reselling them in installments to the general public (Article 9). To encourage participation in this operation, the Act temporarily (1973-1976) exempted participating organizations from paying corporate income taxes on capital gains obtained within six months after the offering (Article 15).

2.3 Incentives for IPO

The Act gave firms a variety of economic incentives to go public. First, the Act permitted public or designated firms the opportunity to revalue their real estate assets annually, even if they were not directly used for operations. Normally, such real estate assets had not been eligible for asset revaluations. Moreover, according to the Act, revaluation gains were subject to a special tax rate of 27 percent, well below the normal rate of 40 percent (Article 12). Second, the Act gave a 50 percent tax

[10]A year earlier (Dec. 28, 1971), the Corporate Income Tax Code was revised in the same direction. The upper ownership limit per shareholder was set to be 51 percent. Previously, it had been 60 percent.

exemption on dividend income to shareholders (together with related parties) who owned less than 30 percent of outstanding shares (Article 13).

Third, if a designated firm had complied with the government order and went public, it was pardoned of previous tax evasion crimes, provided that it would correct its financial statements prior to the date the Act takes effect (1973. 1. 5) (Article 14).

2.4 Penalties for Non-Compliance

The penalties established in the Act were as provocative as the incentives. If a designated firm refused to comply, it faced the following penalties during its period of non-compliance: (i) the interests on debt borrowed from shareholders or management could not be expensed, (ii) entertainment and other similar costs could be expensed at a rate only half of other compliant firms, (iii) special depreciation privileges granted to firms with honest tax filing records could not be allowed, and (iv) a 20 percent increase in corporate income tax would be required.

Second, the Act penalized not only non-complying firms, but also their shareholders. The shareholders would face a 20 percent increase in their general income tax payments. Probably the most effective tool, however, was the Minister of Finance's power to ask financial institutions to limit their lending and other assistances to non-complying firms.

3. *Implementation of the Act*

3.1 IPO Review Committee during 1973-1974

On March 10, 1973, the government formed the IPO Review Committee by appointing five civil members. The first meeting was held on March 22, presided over by Jong-Pil Kim, the Prime Minister. At this meeting, the Committee selected 110 firms to request the submission of their financial statements by April 12. These firms were either (i) firms that had foreign debt of more than 5 million dollars, (ii) firms that had restructured its debt under the Emergency Measure of August 8 in the amount of more than 500 million won, or (iii) firms that had borrowed more than 1 billion won from domestic financial institutions (DongA Daily Newspaper 1973. 5. 22). 104 firms submitted their financial statements by the deadline, with four submitting statements after the deadline, and two not complying at all.

On July 23, the IPO Review Committee meeting conducted its second meeting, and decided to add firms with restructured debt greater than 100 million won to the target list. This resulted in an additional 350 firms (Maeil Business Newspaper 1973. 7. 23). They had to submit their financial statements by the end of August.[11] At the same meeting, 40 out of 108 firms that had previously submitted their financial statements were identified as qualified firms. Among these 40 firms, 14 had already gone public, 12 were identified as firms for whom an IPO was feasible, and the

[11]In 1973, the Ministry of Finance made a visit to Bovespa (Sao Paulo Stock Exchange). The visit was recommended by the head of United States Operations Mission (USOM). USOM was later renamed as USAID-K.

remaining 14 were regarded as unqualified. Public offering orders, however, were not issued at this time, with Prime Minister Jong-Pil Kim giving instructions that IPOs should be carried out voluntarily.

The IPO Review Committee met two additional times, in September and November. No additional firms were added in the target list, nor were there any firms that received a public offering order from the government. By April 26 of the following year, the Ministry of Finance had completed its due diligence of 32 firms, which were asked to submit offering details, including number of shares to be offered, terms, and the offering date.

3.2 Oil Shock of 1973 and the Slow Progress

Table 6 summarizes the stock market performance during the period of 1971-1974. Thanks to rising stock prices up to 1973 (stock prices had peaked in July of 1972 at 394), most stock market indicators were showing improvements during this time. Market capitalization, the capital stock of listed firms, the number of listed firms, the increase in the amount of paid-in capital, the number of shareholders, aggregate share holdings by small-scale investors (holding less than 1,000 shares), and turnover statistics all showed progress. This was by no means a coincidence. 1973 was also a year in which Korea grew by 14.8 percent in real terms.

This upward trend, however, was interrupted by the oil shock that hit the economy near the end of 1973. Consequently, in 1974, only 26 firms were newly listed on the stock exchange. During 1973-74, in fact, there were firms that even experienced a decrease in capital or were delisted altogether.

TABLE 6—STOCK MARKET STATISTICS, 1971-1974

	Unit	1971	1972	1973	1974
Stock Price Index	1972 = 100	-	227	311	297
Market Capitalization	Million won	108,706	245,981	426,247	532,824
Capital Stock Listed	Million won	141,357	174,339	251,620	381,343
No. of Listed Firms	New (Delist)	2	16	40 (2)	26 (2)
	Cumulative	50	66	104	128
Paid-in Capital Increase	No. of Firms	7	31	53	62
	Million won	2,090	15,175	33,617	37,052
Public Offerings	No. of Firms	4	7	47	19
	Million won	850	1,080	21,475	14,337
No. of Shareholders	-	81,923	103,266	199,999	199,613
Share Ownership by Small-scale Investors	%	2.83	3.37	5.94	4.91
Yearly Turnover	Yearly	0.30	0.43	0.53	0.39
Economic Growth Rate	Real GDP %	10.4	6.5	14.8	9.4

Notes: Small-scale investors refer to those holding less than 1,000 shares. Yearly turnover is measured as follows: (total number of shares traded per year / total number of shares outstanding at year-end).

Source: Securities Market Yearly Statistics (1975) and Bank of Korea (ECOS).

3.3 Special Presidential Order of May 29

Due to the government's measures to lower import tariffs, Korean firms endured the oil shock of 1973 without much difficulty. Firms did not make much progress in their IPOs, however, which caused President Park to intervene. Based on the advice by the Chief Secretary of Economic Affairs, President Park issued a special order to his cabinet on May 29, 1974, entitled the "Five Special Orders on Firms' Public Offerings and Corporate Culture."

Stock price soared upon the news of the President's special order, but the responses from firms were not encouraging. They were still concerned with the possibility that newly offered shares may not be fully purchased with, and the possibility of losing control over their businesses (Chosun Ilbo 1974. 5. 31).

Amidst this stalemate, the government decided to ask for cooperation from Sung-Kohn Kim, the head of the Korea Chamber of Commerce and Industry, hoping that if he decides to go public with Ssangyong Cement Industrial, it may trigger others to follow. Yong-Hwan Kim, the Chief Secretary of Economic Affairs, invited Chairman Kim to the Blue House and proposed a deal (Kim 2002). The decision to make this deal was not easy for Chairman Kim, as he had great concerns over losing corporate control. He nevertheless could not refuse the government's request. On July 8 1974, Chairman Kim called a press conference and announced his plan for Ssangyong Cement Industrial's IPO.

3.4 IPO Supplementary Measures of August 8

Despite such efforts, it remained rare for a key blue-chip firm within a group to go public. Firms that went public were mostly secondary firms within a group. To address this situation, the government on August 8 1975 announced its IPO Supplementary Measures.

The Supplementary Measures of August 8 included a new set of target firms: (i) primary firms within a Chaebol group, (ii) the top 100 firm in terms of company size, (iii) firms with more than 3 million dollars of foreign debt, (vi) the top 100 exporting firm, (v) firms classified as a qualified firm according to the KIDC, or (vi) firms in the HCI sector.[12]

3.5 Other Government Measures

Besides the Supplementary Measures of August 8, there were other government policy measures that later greatly facilitated public offerings by firms. One was the Capital Market Preparation Measures, announced in June of 1974. This measure was designed to prepare the capital market for large public offerings by forming a syndicate of financial institutions that would purchase unsubscribed shares from issuers, later reselling them to the general public. KIDC and securities firms with

[12]For the details pertaining to the promotion policy for heavy-equipment and chemical industries, see Kim (2011).

equity capital above 300 million won were the key participants. Besides underwriting, the Capital Market Preparation Measures included policies on securities savings, securities investment trusts, and employee stock ownership plans.

In December of 1976, the Securities and Exchange Act also underwent a major revision. The revisions included the establishment of: (i) the Securities Management Commission (SMC) and the Securities Supervisory Board (SSB), (ii) a 10 percent ownership limit in listed firms[13], (iii) the *ex post* management of listed firms, (iv) supplementary measures to improve corporate disclosures, and (v) measures to prevent insider trading.

Related to corporate disclosure, the Act mandated firms to register at least one before their listings and required a number of disclosures. To prevent insider trading, the Act banned stock trading by company management and employees. The Act also mandated that company management, employees, and major shareholders (owning more than 10 percent) return their capital gains back to the company if the gains were obtained by selling (or purchasing) company shares within six month after their purchase (or sale).

4. *Outcome and Evaluation*

4.1 Outcome

The government made public the list of qualified firms and their public offering schedules on October 6, 1975 and July 1, 1976. In 1975, it included 105 firms, from which 30 were strongly recommended to go public before the end of the year. In 1976, the government added 101 firms to the list to go public between the second half of 1976 and the first half of 1977. Many firms, however, could not go public due to profitability - or capital structure -related reasons. Among the 46 firms designated to go public in 1976, only 20 complied. Sometimes, very profitable firms refused to go public during this time, the most noteworthy example being Hyundai Construction.[14] On March 15, 1978, the Securities Supervisory Board organized a meeting with firms that were recommended to go public, strongly warning that if they did not comply, public offering orders would be issued, along with appropriate sanctions (Kyunghyang Shinmun 1978. 3. 15).

[13]According to Article 200 of the Securities and Exchange Act, no shareholder was allowed to own more than 10 percent of outstanding shares in a listed firm. Shareholders owning more than 10 percent of shares at the time of listing, however, were not subject to this rule.

[14]The reason behind Hyundai Construction’s continued refusal to go public boils down to its offering price. Hyundai Construction, which became a global player in 1976 by winning Saudi Arabia’s Jubail port contract (worth 960 million dollars), wanted to offer its shares at 7,000 won per share. This was significantly higher than the 3,000 won suggested by the government (Maeil Business Newspaper 1977. 6. 4). Despite such disagreements, in 1977, the government and Hyundai Construction struck a deal to go public. However, this decision was overturned at the last moment when Chairman Ju-Yung Chung succeeded in persuading President Park that Hyundai Construction would build five general hospitals around the country if it could remain private. Chairman Chung calculated that investors would benefit by 50 billion won if Hyundai Construction shares were to be offered below its true value. He promised that the same amount of money would be used to build hospitals. The origin of the Asan Medical Center can also be traced back to this promise. The Asan Medical Center is now one of the most prestigious hospitals in the country (Koh 2008).

TABLE 7—STOCK MARKET STATISTICS, 1974-1978

	Unit	1974	1975	1976	1977	1978
Stock Price Index	1975 = 100	105.0	139.4	146.8	178.2	207.2
Market Capitalization	Billion won	533	916	1,436	2,351	2,892
Capital Stock Listed	Billion won	381	643	1,153	2,117	2,959
No. of Listed Firms	New (Delist)	26 (2)	62	87	49	33
	Cumulative	128	189	274	323	356
Paid-in Capital Increase	No. of Firms	62	68	81	97	148
	Million won	37,052	82,929	101,941	141,859	285,201
Public Offerings	No. of Firms	19	62	87	49	33
	Million won	14,337	39,875	74,005	44,113	41,521
No. of Shareholders	-	199,613	290,678	568,105	395,275	963,049
Share Ownership by Small-scale Investors	%	4.91	5.31	3.58	3.38	6.59
Yearly Turnover	Yearly	0.39	0.51	0.51	0.71	0.56
Economic Growth Rate	Real GDP %	9.4	7.3	13.5	11.8	10.3

Notes: Small-scale investors refer to those holding less than 1,000 shares. Yearly turnover is measured as follows: (total number of shares traded per year / total number of shares outstanding at year-end).

Source: Securities Market Yearly Statistics (1979) and Bank of Korea (ECOS).

Although some firms refused to go public, overall, the government's effort was deemed a success. Table 7 shows the development of the Korean stock market during the period of 1974-1978. One can see that the number of listed firms and the amount of paid-in capital increased significantly, along with a rising stock market index. In September 1976, the government celebrated its efforts in raising more than 1 trillion won in equity capital during a one-year period. During the three-year period between 1975 and 1977, nearly 300 firms went public (Koh 2008). Low interest rates and high economic growth rate were important factors behind this growth. In 1975, dividend yields for listed firms averaged 23.3 percent, whereas the time deposit rate was only 15 percent (Rhee *et al*. 2005). Korea also experienced three consecutive years of two-digit real GDP growth rate during the period of 1976-1978.

4.2 Evaluation

Although the government threatened on a number of different occasions that it would penalize non-compliant firms, it never sanctioned any company. Nevertheless, the government made significant achievements in increasing the number of listed firms. The success factors can be summarized as follows. First, the low interest rates that prevailed during this period contributed most to this success. With relatively high stock returns and dividend yields, investors were attracted to the stock market. With a much greater investors' base, large-scaled public offerings were placed successfully without much difficulty. On top of this, the influx of dollar receipts from the construction boom in the Middle East resulted in an expansionary monetary policy and a stock market boom.

Second, rapid economic growth was also crucial. Facing increased demand, firms had to raise new capital and were motivated to go public voluntarily. As mentioned earlier, the period during which the number of listed firms increased the most overlaps Korea's two-digit real GDP growth rates for three consecutive years (1976-1978). Third, President Park's incessant and unwavering support was also crucial.

The Special Order of May 29 and occasional instructions at monthly economic development meetings were just a few examples of his support. Without his support, Korea's IPO promotion policy would not have been pursued consistently over the five-year period (1973-1978).

Fourth, the government's timely introduction of various securities-related measures also helped alleviate the concerns of company owners and investors. For example, the 10 percent ownership limit greatly alleviated the concern over losing corporate control. The underwriting syndicate, formed to provide firm-commitment underwriting, helped to absorb large-scale public offerings. Mandatory registration and the prior disclosure of financial statements alleviated investors' concerns over firms' lack of transparency.

An interesting way to understand the policy efforts in the 1970s is by looking at them from the perspective of mitigating information asymmetry, and preventing adverse selection problems. The challenge faced by the Korean government in the 1960s and '70s was to overcome these problems without a good disclosure rule or securities law. The option taken in the 1960s was to set up the KIDC, which would serve as a reputational intermediary, which did not work out as intended. The policy measures taken in the 1970s were an improvement over those in the 1960s in the sense that the government was directly involved in differentiating between high and low quality firms. By going through the financial statements and designating qualified firms, the government served as a trustworthy screening agency. However, the offering prices set by the government were too low for high quality firms. As a result, they refused to go public, as in the case of Hyundai Construction. This problem was partially resolved in the 1980s when the offering price were allowed to be set higher than the par value, which led high quality firms to offer their shares in the market voluntarily.

Another interesting question is whether this coercive and interventionist approach helped. My investigation shows that such an approach partially contributed to the IPO boom during the late 1970s. By being directly involved in differentiating between high and low quality firms, the government greatly mitigated the information asymmetry problem. Also, the incentives it offered and penalties it threatened to impose aligned the interests of both the government and the designated firms. Their effects were, however, heavily influenced by improvements in macroeconomic conditions. Before the economic boom, the number of IPOs increased only moderately. Nonetheless, when the economy boomed, the number of IPOs also accelerated.

The government's success in increasing the number of IPOs was tarnished by a bubble that formed in 1978. With the construction boom in the Middle East, construction companies became overly subscribed by investors, while other sectors experienced under-subscription (DongA Daily Newspaper 1978. 6. 7). In 1976, the portion taken up by construction firms in the total number of public offerings and the increase in capital were respectively 9.7 percent and 1.4 percent. These corresponding figures increased to 63.9 percent and 25.4 percent in 1978 (Rhee *et al*. 2005). Although many construction firms went public during the bubble years, interestingly, the top-ranked firms did not. Hyundai Construction is a good example.

The government failed to detect and correct the imbalances that emerged in the stock market by the second half of 1978. There were too many shares being offered, compared to the size of the stock market's investor base. Coupled with the government's tight monetary policy to fight inflation and a second oil shock, the stock market soon crashed, failing to recover for many years afterward (Rhee *et al.* 2005).

C. *The Equity Offering Expansion Policies in the 1980s*

1. *Background*

1.1 Stock Market Stagnation and the Need to Expand the Role of Government

The stock market stagnated for many years after the 1978 bubble burst. Firms started to rely again on bank lending and private loans. Naturally, firms' debt-to-equity ratio deteriorated. Amidst this backdrop, in October of 1983, Man-Jae Kim became Finance Minister. Unlike his predecessors, he had a deep understanding of and keen interest in capital markets, and he was very active in developing the market during his tenure.

Government policymakers, including Minister Kim, thought that the financial sector was lagging behind the real industrial sector. Undoubtedly, this had to do with twenty years of financial repression during the period of government-led interventionist industrial policies. However, within the financial sector, the stock market was in a worse condition. The financial system was considerably bank-centered. To diversify external financing sources and to improve the capital structure, there was a strong need initially to normalize and then to expand the capital market.

It is important here to note that the nation-wide resource mobilization, which was an important policy goal behind capital market development policies in the 1970s, did not play a key role during this particular period.

1.2 The Three Lows and the Economic Boom

During the second half of 1980s, Korean economy enjoyed an extremely favorable external environment, what has been termed the Three Lows, referring to low international interest rates, a low value of the Korean won, and a low price of crude oil. With low international interest rates, the debt service burden on foreign borrowings dropped significantly. A stronger Japanese Yen against the US dollar, a result of the Plaza Accord, made Korean export goods relatively inexpensive. Lower crude oil price significantly lowered production costs as well. Consequently, Korea's current account turned in to a surplus after many years of chronic deficit. The real GDP growth rate, which was 9.9 percent and 7.5 percent, respectively in 1984 and 1985, increased to 12.2 percent, 12.3 percent, and 11.7 percent, respectively in 1986, 1987, and 1988.[15]

[15]There were two occasions when Korea experienced three consecutive years of double-digit real GDP growth rate. One occurred in the second half of the 1970s (76-78) and the other was during the second half of the 1980s (86-88).

Such an economic boom undoubtedly helped the government's policy to expand equity offerings. Faced with a greater demand for their products, firms had to increase their capital expenditures. The resulting stock market boom meant that they could raise equity at a lower cost. There were also plenty of investors willing to purchase newly issued shares. Also, with rising per capita income and wealth, a greater number of people participated in the stock market.

1.3 Market Opening and Privatization

Capital market internationalization was first contemplated in January of 1981, when government announced its Long-Term Plan on Capital Market Internationalization. In preparation for the opening of Korea's market, it became very important to enlarge the size of the stock market.[16] The need to privatize SOEs also made it necessary to expand the stock market. For the government to sell shares directly in the stock market, it was deemed very important to have a well-developed primary market.

2. *The Policy Details*

The equity offering expansion policy in the 1980s, the subject matter of this section, refers to a series of policy measures announced and implemented during the period of 1983 to 87, either to encourage public offerings or to expand the investor base. The policymakers at the Ministry of Finance believed that they should give priority to the former over the latter, if they were forced to choose between the two. They thought that once blue-chip shares were offered, this naturally attracted investor demand, i.e., supply essentially creating demand. Following this logic, the government focused on policy measures that would either induce or coerce blue-chip firms to offer their shares in the open market.

The most comprehensive package of measures to expand equity offerings was announced in June of 1987. First, so that blue-chip firms would offer their shares, the government devised a number of incentives for them. They included (i) relaxing the market-price share offering rule, (ii) strengthening tax benefits, (iii) relaxing asset revaluation requirements, (iv) relaxing the cap on corporate bond issuances and stock dividends, (v) allowing for the issuance of exchange bonds and participation bonds, and (vi) relaxing the cap on the issuance of preferred shares.

Second, to enlarge the stock market's investors' base, the government introduced a number of measures, including (i) privileged access to IPO stocks given to holders of long-term savings accounts, (ii) strengthened regulation pertaining to insider trading, and (iii) supplementary measures to improve company disclosures. To support employee stock ownership associations, they were given 20 percent preemptive rights over publically offered shares. Previously, these associations had 10 percent

[16] Market opening was carried out in a gradual manner. First, foreigners were allowed to invest indirectly through country funds listed on the NYSE (e.g., Korea Fund established in August of 1984). Second, foreigners' direct equity investment in the Korea Stock Exchange was allowed in January of 1992. Finally, limits on foreign ownership were completely lifted in May of 1998.

preemptive rights. Third, the government designated firms in nationally important industries (hereafter "public interest firms") and came up with ways to protect these entities from takeovers, including ownership limits and restrictions on foreign acquisitions.

Most of the measures announced in June were incorporated into the Capital Market Development Act, revised on November 28. Also, the IPO Promotion Act was repealed and merged into the revised Capital Market Development Act. With the repeal of the IPO Promotion Act, the term 'IPO order' was also replaced with the term 'IPO recommendation'.[17] The key contents of the revised Capital Market Development Act can be summarized as follows.

First, the government had the power to recommend IPO or SEO, according to the criteria (regarding size of capital and profitability) outlined in the Enforcement Decree. For non-compliant firms, the government also had the power to refuse the receipt of their public offering applications for a pre-specified period of time (Articles 3 and 5).

Second, the revised Act raised the limits on the dividends that a company could pay in the form of shares, from 50 percent to 100 percent of the total amount of dividends (Article 8). The Act also relaxed the ceiling on the issuance of convertible bonds (CBs) and bonds with warrants (BWs). The converted shares and exercised shares were excluded from the amount of issuance (Article 11).

Third, the revised Act also introduced provisions that facilitated the sale of government-owned shares. For example, shares were allowed to be sold to the general public with no limitations, provided that doing so would help to disperse share ownership (Article 12). The Act also allowed government-owned shares to be sold to employee share ownership associations at a discount; in addition, employees would be allowed to pay for them in installments (Article 13). The Act also allowed the government to limit eligible acquirers and the maximum number of shares they would be able to acquire (Article 14).

Fourth, the revised Act introduced provisions to strengthen employee stock ownership associations. For example, dividends from firms in nationally important industries could be paid out, in full or in part, to employee stock ownership associations (Article 15). Also, the preemptive rights given to employee stock ownership associations were raised from 10 percent to 20 percent of newly offered shares (Article 17). Listed firms were allowed to hold treasury stocks for a year. if they were purchased to pay out bonuses to employee stock ownership associations.

Fifth, for firms operating in nationally important industries, the Act restricted, for national security reasons, shareholders' book inspection rights (Article 24).

[17] Although the Act used a softer term, it did not mean the government was taking a softer approach. In reality, the IPO recommendations in the '80s were no different from IPO orders in the 1970s.

3. *Outcomes and Evaluation*

3.1 Outcomes

In the beginning, not all firms were enthusiastic about public offerings. For example, only 40 out of the 59 firms (11 Chaebol member firms and 44 non-Chaebol firms) that received IPO recommendations on April 29 1986 from the Securities Supervisory Board, submitted their IPO plans by the May 20 deadline (Maeil Business Newspaper 1986. 4. 29, 1986. 5. 21). Nineteen firms refused to comply, despite threats of bank loan restrictions. By October of 1988, only five out of 59 firms designated in 1986, 16 out of 77 firms designated in 1987, and six out of 15 firms designated in 1988 went public (Kyunghyang Shinmun 1988. 10. 24).

TABLE 8—STOCK MARKET STATISTICS, 1985-1989

	Unit	1985	1986	1987	1988	1989
KOSPI	1980 = 100	139.53	161.40	264.82	532.04	919.61
Market Capitalization	Billion won	6,570	11,994	26,172	64,543	95,477
Capital Stock Listed	Billion won	4,665	5,649	7,591	12,212	21,212
No. of Listed Firms	New (Delist)	11 (5)	17 (4)	35	115	124
	Cumulative	342	355	389	502	625
Paid-in Capital Increase	No. of Firms	60	110	178	298	274
	Billion won	260	798	1,656	6,721	11,125
Public Offerings	No. of Firms	11	16	44	112	135
	Billion won	35	43	244	1,049	3,545
No. of Shareholders	-	772	1,410	3,102	8,541	19,013
Share Ownership by Small-scale Investors	%	9.76	13.27	20.12	24.21	23.74
Yearly Turnover	Yearly	0.72	1.11	1.30	1.54	1.12
Economic Growth Rate	Real GDP %	7.5	12.2	12.3	11.7	6.8

Notes: Small-scale investors refer to those holding less than 1,000 shares. Yearly turnover is measured as follows: (total number of shares traded per year / total number of shares outstanding at year-end).

Source: Securities Market Yearly Statistics (1989) and Bank of Korea (ECOS).

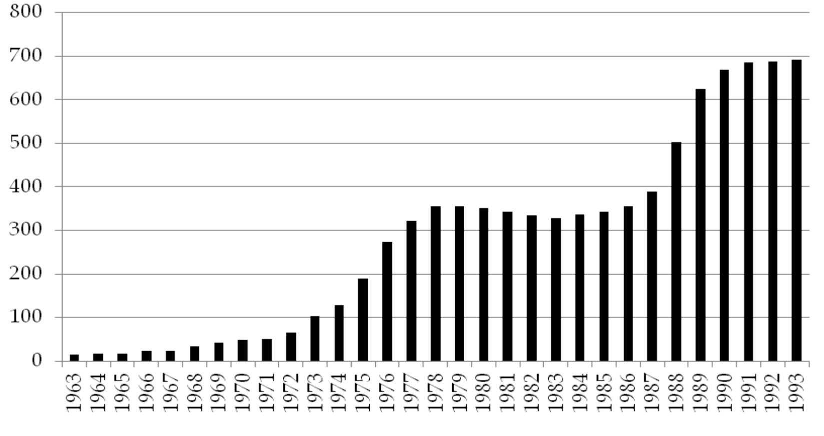

FIGURE 1: THE NUMBER OF LISTED FIRMS, 1963-1993

Source: Securities Market Yearly Statistics.

Occasionally, the Securities Supervisory Board summoned executives from non-complying firms in order to pressure them to go public.

The situation changed in later years. As shown in Table 8, the number of newly listed firms, which was only 35 in 1987, jumped to 115 in 1988 and 124 in 1989. Figure 1 shows the number of listed firms from 1963 to 1993. One can easily visualize that there were two IPO waves, one during the late 1970s and the second during the late 1980s.

There were also increases in paid-in capital and public offerings. As shown in Table 8, there were increases of approximately 4.9 trillion won of public offerings and 20.6 trillion won increase of paid-in capital during the period of 1985-1989. The introduction of market-price share offering greatly contributed to this increase. Other stock market indicators improved as well. During the four-year period between 1985 and 1989, the number of stock investors, the KOSPI, and the amount of listed capital stocks increased respectively by 24.6, 6.6, and 4.5 times. During the same time period, turnovers of listed shares (0.72 → 1.12) and the percentage of shares held by small-scale investors (holding less than 1,000 shares) increased respectively by 9.76 and 23.74 percent.

The composition of external financing also improved over time. In 1988, the fraction of equity financing accounted for 39 percent. This was in great contrast to the level of only 8 percent in 1968. With the increase in equity financing, the capital structure also improved. Debt-to-equity ratio which was 462 percent in 1980 dropped to 260 percent by 1989. Also, the interest coverage ratio, which was less than 100 percent in 1980 jumped to 162 percent in 1986.

In 1988 and 1989, it was not uncommon to see firms offering shares at high premiums. For example, Saehan Media and Daeduck Industrial offered their shares respectively at 500 and 300 percent premiums. These shares were also correspondingly oversubscribed by 10.5:1 and 45:1 (Rhee *et al*. 2005). Facing favorable market conditions, firms went public and increased their paid-in capital voluntarily, and there was no need for the government to exert any pressure. In contrast, the government had to become stricter in its screening process of firms that had applied to go public.

The second half of 1980s also witnessed an increase in preferred share issuances. Preferred shares became popular among firms that did not want to dilute the shares held by their controlling families. Stock investors also did not object to investing in them, as they did not prioritize voting rights. The very first preferred share issuance was accomplished by Oriental Brewery in June of 1986. The issuance of preferred shares, which accounted for only 1 percent of all paid-in capital increases in 1987 jumped to 36 percent by 1989 (Rhee *et al*. 2005).

However, preferred shares issued in those years diffed from those that have been allowed since 1996. Pre-1996 preferred shares had dividend yields which were one percent higher than those of common shares. Although dividend yields were higher than those of common shares, these figures fluctuated over time. Post-1996 preferred shares, on the other hand, provided a fixed dividend yield. In some sense, pre-1996 preferred shares were similar to non-voting common shares. With the revision of the Commercial Code in 1996, the issuance of such preferred shares is now banned.

3.2 Evaluation

The success in expanding share offerings in the second half of 1980s is, to a large extent, attributable to the aforementioned ‘Three Lows’ and the resulting economic boom. Firms, facing increased demand for their products and recognizing the need to raise more capital, became more inclined to go public or increase their paid-in capital. With higher income and wealth, a greater percentage of the population became stock investors, thereby expanding the stock investor base we well.

The government also played an important role. Two measures were noteworthy in particular. The first of these was the liberalization of offering prices at the time of an IPO. The second was the introduction of market-price share offerings for listed firms. The regulations on IPO offering price, on which restrictions had been considerably relaxed in April of 1987, were completely liberalized in June of 1988 (Rhee *et al*. 2005). Given this degree of liberalization, many firms were able to offer their shares at premiums. As a result, the cost of equity capital fell significantly, from 24.3 percent during the period of 1982-1983 to 9.3 percent during the period of 1986-1990 (Rhee *et al*. 2005).

The rise in paid-in capital was attributable to market-price share offerings, which were, in return, attributable to increasing demand for stocks. Firms also benefited by retaining the difference between market price and par value. This difference was classified as a part of book equity referred to as capital surplus reserves.

In the beginning, the government allowed market-price share offerings only under limited circumstances. However, soon thereafter, it began to require it for all firms, provided that their share price was 10 percent above par value (February 1987). This action was prompted to combat distortion in the market, arising when investors preferred to purchase distressed firms that were offering shares at par value over blue-chip firms offering shares at market price. In September 1989, the government removed all of the remaining restrictions on market-price share offerings (Rhee *et al*. 2005). The maximum discount rate applied to market price was also lowered from 50 percent in 1987 to 10 percent in 1989. Market-price share offering, as a percentage of total paid-in capital, increased from 4-6 percent during the period of 1984-1985 to 100 percent by 1989. The average premium (over par value) also increase from 11 percent in 1986 to 340 percent by 1989.

Overall, the government’s share offering expansion policy was a success, but was not without problems. First, share offerings increased in the late 1980s, disproportionately exceeding their demand. KOSPI, which peaked around the period of March-August 1989, nosedived continuously until it hit the bottom in July of1992. A number of individuals who had invested with borrowed money committed suicide out of despair. Of course, it was somewhat inevitable for share prices to drop after public offerings, as firms generally offer shares when their share prices are peaking. This, however, does not mean that the government is helpless and should not be held accountable. To prevent a hard landing, it should closely monitor the market, and if necessary, preemptively intervene in the primary market by limiting the amount of share offerings, or inducing greater demand for stocks. This was what the government did when it announced a stock market stabilization plan in November of 1989. However, it was too late to prevent the downfall.

Second, controlling shareholders were criticized for intentionally diluting the value of their company shares before their IPOs, thereby reaping capital gains afterwards. This scheme worked in the following way. First, controlling shareholders significantly increases the number of shares they hold, e.g., by reclassifying asset revaluation reserves as capital stock. The number of new shares existing shareholders receive equals the amount of reserves that had been reclassified divided by par value. If per share net asset value is greater than the par value, existing shareholders make a capital gain. However, per share net asset value itself falls after the reclassification. This is so because the total number of outstanding shares increases without any new capital injection. This results in a capital loss for the existing shareholders exactly offsetting the initial capital gain. In other words, reclassification *per se* does not result in any net gain to the existing shareholders.

It makes a major difference, however, when the post-IPO share prices remain high, regardless of how many pre-IPO share issuances there were. With a stock-buying spree, this was the market environment in the late 1980s. Firms were able to offer shares at 300-400 percent premiums, regardless of their pre-IPO share issuances. As a result, the existing shareholders, mostly Chaebol families, reaped huge capital gains. A numerical example can make this point clear.

Suppose there is a private firm with a net asset value of 1 billion won. If there are 100 thousand outstanding shares, the per-share net asset value is 10 thousand won. For simplicity's sake assume that the founder owns 100 percent of these shares. Par value per share is fixed at 5 thousand won.

Suppose now this firm revalues its assets and the net asset value of this firm increases to 1.5 billion won. On the right-hand side of the company's balance sheet, the shareholder equity is now divided into capital stock (1 billion won) and reserves (0.5 billion won). The per-share net asset value is now 15 thousand won. The total value of shares held by the founder is 1.5 billion won (15,000 x 100,000).

Now suppose the firm increases the number of outstanding shares by reclassifying asset revaluation reserves as capital stock. Capital stock now has a value of 1.5 billion won and the number of outstanding shares reaches 200 thousand (= existing 100 thousand + 0.5 billion divided by par value, 5 thousand won). This means that the per-share net asset value is 7,500 won (= 1.5 billion divided by 200 thousand shares). The share value is diluted from 15,000 won to 7,500 won, but the total value of the shares held by the founder remains at 1.5 billion won.

However, let us suppose now there is a bubble in the market and that the IPO offering price will be set at 20,000 won regardless of the pre-IPO share issuance. In the absence of pre-IPO share issuance, the post-IPO value of the shares would be worth 2 billion won (= 20,000 x 100,000). However, with a pre-IPO share issuance, the post-IPO value of shares would be worth 4 billion won (= 20,000 x 200,000).

Third, the introduction of preferred shares was a violation of one-share, one-vote principle, as the preferred shares that were introduced were more akin to non-voting common shares. In effect, the government approved a *de facto* dual class equity system. Consequently, chaebol families were able to have control rights well above their cash flow rights. However, surprisingly, there was hardly any opposition to the concept of preferred shares initially. Problems with this system, however, gradually emerged. In late 1989, controlling shareholders dumped their preferred share holdings, which triggered a further share price drop of these shares (Rhee *et al*. 2005). These shareholders did not, however, dump common shares, in an obvious attempt to retain control. Incidents of preferred shares being used for stock price manipulation also later emerged. Any new issuance of problematic preferred shares was finally outlawed in 1996, through the revisions to the Commercial Code in November of 1995.

4. *Implications for Developing Countries*

The lessons that can be drawn from the second half of the 1980s are very similar to those mentioned in the previous section. As before, the macroeconomic situation was the most decisive factor. Massive public offerings would not have been possible without the Three Lows, and the resulting economic boom. If policymakers from developing countries wish to induce more equity offerings, they should concentrate their efforts during a stock market boom.

Second, it should be noted that an economic boom alone is not sufficient in and of itself. The government must take timely measures to remove obstacles that may be hindering equity offerings. In Korea, there were two important measures that served such a purpose: the liberalization of IPO offering prices and the introduction of market-price share offerings by listed firms.

Third, in order to change firms' perception of the stock market, it is important to engage in continuous education and public campaigns. In the 1960s and '70s, the stock market was perceived as a place for gambling. By the second half of 1980s, capital market was well-recognized by firms as a source for the raising of long-term capital.

Fourth, it is important ensure that the magnitude of public offerings does not exceed their demand. If it does, the government should abandon their yearly listing targets and try to restrict share offerings. To a certain extent, an economic boom is not unlike a double-edged sword. It induces new share offerings while concurrently, bringing a stock price bubble that attracts inexperienced and naïve investors into the stock market. When the bubble inevitably bursts, it leaves many damaged investors behind, some deep in debt.

Fifth, the government's coercive approach did not make much of a difference either way.[18] As discussed earlier, the number of newly listed firms closely followed real GDP growth rate or the stock price index. During a recessionary economy, however, firms refused to go public even in the presence of government pressure.

III. Other Supplementary Policies

The primary market, in which firms offer shares, is closely intertwined with the secondary market, where those shares are traded among investors. If share prices are set inadequately or transaction costs are too high in the secondary market, firms will

[18]Although the political system had been democratized in the second half of the 1980s, the government was able to use coercive measures, such as restricting bank loans, because most financial institutions were still under government control.

have difficulty discovering favorable offering prices, and investors will face liquidity constraints. An advanced capital market is one in which both markets are well-developed. In Sections 1 and 2 of this Chapter, a number of policies that shaped the secondary market in the 1970s and 80s are outlined.

It is also clear that the primary market cannot be enlarged simply by increasing the supply of shares. There should be a commensurate increase in the investor base of the stock market. In the absence of a wide investors' base, the supply of, and the demand for, shares would show a great imbalance, ultimately hindering the development of the stock market. Since the 1960s, the Korean government has made a series of efforts to expand the stock market's investor base. In Section 3 of this Chapter, I cover the employee's stock ownership plan.

A. *The Introduction of Regular-Way Transaction and the June 3rd Measure*

1. *Background*

Up until 1969, the most popular means of share transaction was the clearing transaction system. This was the case during the Daehan Stock Exchange years and even after the Korea Stock Exchange was established in 1963.[19] Clearing transactions were like today's futures transactions. A buyer (seller) promises to pay (receive) a certain price today but makes the actual payment (delivery) at a later date within one or two months. Also, the buyer and the seller can enter opposite transactions, thereby canceling their initial positions (two-sided orders). In this case, there would be no actual delivery of shares. The transaction was settled by paying or receiving the difference between the two contracted share prices. The exchange required margins from both parties. As opposed to clearing transactions, a cash transaction requires all aspects of a trade, including the delivery of payments, to be finalized on the same date.

Because the transaction required only a small margin, clearing transactions were often used for speculative reasons, sometimes resulting in speculative bubbles. Two episodes during this era are noteworthy, one in 1959 and the other in 1962. In those years, clearing transactions accounted for 80-90 percent of all trading volume.

The 1959 incident took place when speculators amassed Daehan Stock Exchange shares, betting on the possibility that it would be reorganized as a stock company, and that investment certificates would be exchanged with shares. The stock price jumped from 39 chon in February to 90 chon in May of 1959. Chon was the currency unit used before the introduction of won by the June 1962 currency reform.

[19]The Daehan Stock Exchange existed from March of 1956 to December of 1962. The Korea Stock Exchange (KSE) existed from January of 1963 to December of 2004. It is important to note the nature of their legal entities. The Daehan Stock Exchange was initially not a stock company, but was able to issue investment certificates that were traded like stocks in the secondary market. Three months after the enactment of the Securities and Exchange Act in January of 1962, the Daehan Stock Exchange became a joint stock corporation. However, a speculative bubble, which burst during the first half of 1962, led Daehan to be reorganized into a government-run, non-profit corporation in 1963. It was also renamed as the Korea Stock Exchange. In 1988, it was privatized and reorganized again as a membership organization. Its successor, the Korea Exchange (KRX) is a joint stock company.

During the period of March-May of 1962, speculators again amassed Daehan Stock Exchange shares. This time, it was triggered by rumors that the stock exchange would complete a massive capital increase. The share price of 9.2 hwan (equivalent to 100 chon) in March jumped to 42.5 hwan in April. The trading volume of Daehan Stock Exchange shares also increased dramatically, representing 52.7 percent of the total trade volume by April. The Daehan Stock Exchange was criticized for its lack of timely intervention. A conflict of interest problem was also noted because Daehan Stock Exchange managers were also its shareholders, which made them unenthusiastic about stabilizing the stock market.

With a rising stock price, investors that took a short position were unable to make their payments. The stock exchange was also unable to make the required payments on behalf of the sellers. Ministry of Finance stepped in and pressured the Bank of Korea to extend securities loans to the stock exchange. Chang-Soon Yoo, governor of the BOK, refused to cooperate, and resigned on May 26. The BOK ended up extending a loan of 33 billion hwan by June 1.

The stock market speculation in 1962, however, cannot be solely attributed to the clearing transaction system. Investigations in later years revealed that Jong-Pil Kim, then serving as the head of the Korean CIA, created the speculative environment in order to fund and launch the Democratic Republican Party (Hankyoreh 2005. 3. 1). Kim instructed Korean CIA to give 980 million hwan to Eung-Sang Yoon, who, in return, established three securities firms that purchased massive amounts of Daehan Stock Exchange shares, which in turn triggered the bubble. Yoon was able to provide 6.7 billion hwan to Jong-Pil Kim from these investments.

2. *Detailed Contents*

2.1 The Adoption of Regular-Way Transactions

On February 1 1969, the Ministry of Finance (Minister: Jong-Yeul Hwang) repealed the clearing transaction system, adopting the regular-way transaction system. Under the new system, a trade had to be settled on the following day. One day after the contract, the buyer had to complete payments and the seller had to deliver the shares. Certain exceptions were allowed, some of which resembled the old clearing transaction system. If one party failed to settle on the following day, the settlement period was allowed to be extended, provided that both parties pay margins, and the party which failed to complete the transaction pays a small postponement fee (Kyunghyang Shinmun 1971. 2. 4).[20]

This delayed settlement option, coupled with a 30 percent margin requirement, enabled investors to replicate futures trading, even without entering opposite transactions (Kyunghyang Shinmun 1971. 2. 4).[21] As an example, consider two investors, A (buyer) and B (seller), who wish to trade 2,000 shares of the Korea Securities Finance Corporation (KSFC) on January 1 at 800 won per share. Once

[20]In the beginning, the settlement period was allowed to be extended for 30 days. Later in July 1969, as a measure to boost up the stock market, it was relaxed to 60 days.

[21]In October 1969, the government lowered the margin requirement from 40 percent to 30 percent for Korea Securities Finance Corporation shares.

they deposit a margin of 480,000 won (= 0.3 x 800 x 2,000) at the Korea Stock Exchange, they can enter a *de facto* futures position. If share prices were to rise to 1,000 won by January 10, investor B would receive 80,000 won (= 480,000 – 400,000) from the Exchange, while investor A would receive 880,000 won (= 480,000 + 400,000).

Sometimes positions escalated to alarming levels. A good example of this excess was speculation involving the shares of Korea Securities Finance Corporation (KSFC) in November of 1969. One group of investors took a long position, while the other took a short position. Each party tried to enlarge its position to influence the share price in its favor (Maeil Business Newspaper 1970. 1. 24). When the size of the position increased, even more investors joined the herds. Share prices fluctuated with high volatility, during which investors who were not involved in speculative trading were harmed. These investors staged a demonstration to express their anger and frustrations (Maeil Business Newspaper 1970. 2. 6). With the sheer size of the position increasing to new levels, there was great concern that one of the two parties would default on payment obligations.

2.2 The Measure of June 3rd

The Ministry of Finance (Minister: Duck-Woo Nam), which had shown reluctance to intervene, finally devised a measure on June 3, 1971. First, it required all stock transactions be settled on the fifth day, beginning on August 5, 1971. Second, it also banned two-sided trading, also beginning on August 5. Third, as an interim provision, it ordered all existing and unsettled positions be liquidated within 60 days (Maeil Business Newspaper 1971. 6. 8).

The new measure, however, had to be suspended as securities firms filed injunctions against it. They claimed that the measure infringed upon their property rights. They also pointed out that the measure was based on the Enforcement Regulation, which was in breach of the Securities and Exchange Act. Article 79 of the Act delegated the choice of transaction systems to the Enforcement Decree, but not to the Enforcement Regulation. According to this logic, the administrative order based on the Enforcement Regulation was invalid.

They filed two injunctions, one against the Ministry of Finance at the appellate court on the new transaction system, and the other against the Korea Stock Exchange at the civil district court of Seoul on the interim provision (Maeil Business Newspaper 1971. 6. 16). On June 23, the civil district court of Seoul accepted the injunction against the Korea Stock Exchange. According to the court's verdict, the liquidation order had to be suspended until August 4. In July, speculative positions on the Korea Securities Finance Corporation shares grew even larger. To end the legal dispute, on July 29 1971, the government revised the Enforcement Decree and stipulated that stock transactions must be settled on the fifth day of the contract. The effective date was set to December 1.

Thanks to the Ministry's continuous persuasion and pressure, on August 16, the two parties reached an agreement (Maeil Business Newspaper 1971. 8. 17). Nonetheless, this was not without resistance. For example, the management of Sambo Securities strongly criticized the government and refused to comply, stating that they were forced by the government to give in with substantial monetary losses (Maeil Business Newspaper 1971. 8. 17).

B. *The Introduction of Securities Deposit and Settlement Systems*

1. *Background*

With the June 3rd Measure of 1971, stock transactions had to be settled with the actual delivery of shares, which proved to be very inconvenient. There was the risk that share certificates would be lost, as well as the costs which would be incurred to keeping them. To alleviate such inconveniences, the government decided in 1972 to adopt a securities settlement system similar to those adopted in the US and Japan (Rhee *et al*. 2005). To replicate the U.S. model, the government received technical assistance from USAID during the period of October-November 1972. The key result of this technical assistance was the establishment of a securities settlement system.

2. *Detailed Contents*

2.1 The Establishment of Korea Securities Settlement Corporation (KSSC)

Korea's first securities settlement system was introduced in February 1973, when the Securities and Exchange Act was revised. Initially, securities settlements were carried out within the stock exchange (November 1973 – December 1974). However, the function was soon transferred to the newly established Korea Securities Settlement Corporation (KSSC) on December 6, 1974.[22] The new system, however, made slow progress, which prompted the government on July 7, 1975 to make it mandatory to settle all secondary market transactions by book-entry transfers (Korea Securities Depository 2003).

2.2 Centralized Securities Deposit

With the establishment of the KSSC and its book-entry transfer system, incidents of actual share delivery dropped considerably. But, there was no centralized depositary institution, and stocks were kept in many securities firms. As a result, shares had to be delivered from one securities firm to another (Maeil Business Newspaper 1979. 9. 13). There were even incidents of shares being stolen (Maeil Business Newspaper 1980. 6. 13).

Against this backdrop, on December 20 1979, the Korea Securities Dealers Association decided that it would adopt a centralized depositary system. This system required that securities firm headquarters deposit at the KSSC 100 percent of the

[22] It was renamed the Korea Securities Depository (KSD) in 1994.

shares they administered, and that regional branches deposit at the KSSC at least 70 percent of the shares they administered (Maeil Business Newspaper 1979. 12. 21). Shares deposited at the KSSC, however, did not increase immediately. This led the government to intervene. In January of 1983, the government made it mandatory to deposit at least 90 percent of shares at the KSSC by no later than June 30 (Maeil Business Newspaper 1983. 1. 10). Related to this, on March 31 1983, the Securities Supervisory Board required all institutional investors to settle their transactions through the book-entry transfer system, which was administered by the KSSC.

2.3 Continued Depository System

A problem related to the centralized deposit system emerged early on. Whenever one provided shares as collateral, or transferred shares to a different name, the shares had to be withdrawn from the KSSC. In fact, near the fiscal year-end, securities firms had to withdraw a large number of shares from the KSSC, transfer the shares to another name, and then re-deposit them at the KSSC. In response to this inconvenience, industry experts called for the adopting of a continued depository system (Maeil Business Newspaper 1980. 1. 19). This refers to a system, in which all shares are kept under the name of the depositary agency, and shareholder rights are exercised indirectly through the agency. As a result, shareholders no longer had to withdraw their shares when providing them as collateral or transferring them to another name.

Although its need was well-recognized, the continued depository system could not be introduced immediately. This has to do with the fact that Commercial Code did not allow split votes, or voting in disunity, and that under the continued depository system, all shares are kept under the KSSC's name. This gives rise to a situation, where shares held by the same person (KSSC) are voted in opposite directions. But, this is illegal under the Commercial Code. To resolve this problem, the government revised the Commercial Code in April of 1984 and allowed voting in disunity. In September, it was also decided that the voting rights of shares under KSSC's name will not be exercised, unless requested by the beneficial owner (Maeil Business Newspaper 1984. 9. 22).

The continued depository system was launched in June of 1985, but it took some time for the new system to be commonly accepted. For firms with fiscal years ending in June of 1985, only 30 percent of shareholders had transferred their shares to the KSSC's name (Maeil Business Newspaper 1985. 7. 4).

2.4 Beneficial Owner System

The continued depository system was adopted in 1985, based on a decision made by the Securities Management Commission, and not as a result of the Securities and Exchange Act. To stave off any legal dispute, the government revised the Securities and Exchange Act (promulgated on November 28), and introduced provisions on the continued depository system and the beneficial owner system. The latter system gives beneficial owners the shareholder rights equivalent to those held by shareholders in the registry. The key provisions in the revised Act are summarized below.

First, for securities deposited at the KSSC, the person who is stated in the account book shall be considered to hold the respective securities. Also, if there is a transfer between accounts for the purpose of transferring securities or establishing the right of pledge, the securities shall be considered delivered (Article 174-3). Second, for securities deposited at the KSSC, the depositor and the KSSC shall be presumed to have co-ownership over the deposited securities (Article 174-4). Third, for deposited securities, the KSSC can transfer them to its name and exercise its rights as a shareholder (Article 174-6).

Fourth, if the issuing firm closes the shareholder registry to determine the list of shareholders that can exercise shareholder rights, such as voting rights, the KSSC should immediately notify the issuer the registry of beneficial shareholders (Article 174-7). Fifth, the issuing firm must keep the registry of beneficial shareholders received from the KSSC. This registry shall have the same effect as the registry in the Commercial Code (Article 174-8).

3. *Evaluation and Implications for Developing Countries*

The securities settlement system, the concentrated deposit system, the continued depository system, and the beneficial owner system all made significant contributions in advancing the secondary market. However, they also made contributions to the primary market. If not for the reductions in trading and settlement costs in the secondary market, large public offerings during the second half of 1980s would not have been possible.

One regretful point was the delay in adopting the continued depository system. The necessity was raised in 1980, but this measure was not adopted until 1985. The delay is attributable to the existing Commercial Code, which prohibited split votes. It took much too long to revise the Code.

It is also worth noting that Korea actively benchmarked other countries when adopting its securities deposit and settlement systems. For the securities settlement system, the government received technical assistance from the experts dispatched from USAID. For the continued depository system, the government was influenced by precedents in the U.S., U.K., and Japan (Maeil Business Newspaper 1979. 9. 6, 1979. 9. 21). Considering the case in Korea, other developing countries should also actively benchmark systems in advanced countries when adopting securities deposit and settlement systems.[23]

[23] Since 1995, Korea has offered its own technical assistance on securities systems. The first case was designed and implemented for Vietnam. Some other recent examples include the assistance with a securities IT system (Uzbekistan) and the establishment of a joint stock exchange (Laos and Cambodia).

C. *The Employee Stock Ownership Plan*

1. *Background*

In 1968, the government was criticized for allowing shares of state-owned enterprises to be acquired by a small number of Chaebols, a move clearly against the government's stated goal of popularizing stock ownership. As a way of promoting dispersed share ownership, business and labor alike proposed to the government the introduction of an employee stock ownership plan (Maeil Business Newspaper 1968. 6. 8). The proposal was accepted by the government, and the Capital Market Development Act was enacted in November of 1968, with provisions legalizing employee stock ownership plans (Kyunghyang Shinmun 1968. 11. 9).

The Act had a provision which allowed discounted share offerings to SOE employees (Article 5) and a provision giving company employees preemptive rights to purchase newly offered shares (Article 6). This was clearly a step forward, yet it remained incomplete in the sense that such provisions applied only to listed firms or non-listed public firms.

The employee stock ownership plan was pursued to achieve many goals, such as popularizing stock ownership, building employee wealth, establishing peace between labor and management, instilling company loyalty, motivating workers' willpower, and expanding the stock investors' base.

Despite such enthusiasm, employee stock ownership plans were not widely utilized by firms in the beginning for many reasons. Dividend yields were too low to attract employers to hold shares. Salary levels were also too low to warrant any extra savings through shares. There were no tax benefits for these plans, and top management understood little about them (DongA Daily Newspaper 1972. 12. 28). The government tried to promote employee stock ownership plans in 1972 when it revised the IPO Promotion Act. The Act introduced a provision that allowed company employees a 10 percent preemptive right to buy newly-offered shares (Article 8).

2. *The Supporting Measures of 1974*

The employee stock ownership plans became widely accepted only after July of 1974, when the Ministry of Finance (Minster: Duck-Woo Nam) announced a package of supporting measures. The package was prompted by the May 29th Special Order from the President (see section II.B.3, for details). President Park believed that the employee stock ownership plan, coupled with the factory-level Saemaeul Movement, could greatly promote peace between labor and management (Kim 2006).

Supporting measures can be summarized as follows (DongA Daily Newspaper 1974. 7. 13). First, they introduced a loan program for employees who wished to purchase company shares. Provided that an employee covers 50 percent of stock purchasing costs from his own salary, the company was required to give a loan (no interests during the first year of the loan) to finance the remaining amount. To induce companies to cooperate, interest earnings were excluded from taxable income in later years. If employees purchased old shares, it was also possible for loans to be extended by the controlling shareholder. Again, no interest was charged during the first year.

Second, it encouraged firms to give bonuses and severance payments through company shares. In such payments, a significant portion was exempt from labor income tax obligations. Third, it encouraged nonpublic firms to allocate 10 percent of IPO stocks to employee stock ownership associations.[24] As an inducement measure, shares owned by employee stock ownership associations were regarded as publicly-owned shares.

Fourth, it encouraged firms to sell company shares at a discount. Moreover, to alleviate the employee tax burden, the resulting labor income or gift tax burden was partially exempted. Dividend income received by employees of nonpublic firms was also partially exempted from dividend income tax obligations.

To prevent such tax benefits from being abused, the government made it clear that benefits do not apply to employees owning more than three percent of outstanding shares. Also, to prevent controlling shareholders from disguising their share ownership as employee owned shares, the Ministry required shares held by employees be deposited at the Korea Investment Development Corporation (KIDC) for at least one year for public firms, and multiple years for nonpublic firms until their IPO.[25]

3. *Evaluation and Implications for Developing Countries*

Two years after the announcement of these supporting measures, the number of firms with employee stock ownership associations reached 249 (217 public firms and 32 nonpublic firms) by July of 1976. The number of enrolled employees also reached 91,497 by this time. Among the 249 firms, 202 (including 17 nonpublic firms) were firms which deposited shares at the KIDC. The most exemplary firm was Daewoo Corporation, with all of its 691 employees enrolled owning 6.55 percent of company shares (DongA Daily Newspaper 1976. 7. 10). In 1987, the number of firms with employee stock ownership associations grew to 455.

As mentioned earlier, employee stock ownership plans were introduced to popularize stock ownership, build employee wealth, establish peace between labor and management, instill company loyalty, motivate the will to work, and expand the stock investor base. Among these various goals, two objectives were clearly achieved: popularizing stock ownership and expanding the stock investor base. The employee stock ownership plan played a key role in absorbing newly offered shares during the 1970s and 80s.

Despite such benefits, employee stock ownership plan was not without problems. Enrolled employees would lose both their jobs and their stock wealth, if the company were to go bankrupt. Employee stock ownership plans therefore may not be the most desirable option for someone who simply wishes to diversify one’s wealth.

[24] The 10 percent upper limit was raised to 15 percent in September of 1987.

[25] Since 1977, KSFC became the depositary institution for ESOA held shares. During 1988 and 1993, MoF imposed a restriction that employees cannot sell their shares until they retire.

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