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IL CHONG NAM

WOOCHAN Kim

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IL CHONG NAM*

KDI School of Public Policy and Management

WOOCHAN KIM**

KDI School of Public Policy and Management

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Abstract

In this paper, we review the developments that took place in the 'Big Four' after their full privatization. We show that POSCO, KT, and KT&G, which were privatized to have dispersed share ownership, have relatively high corporate governance standards. We also show that the 'Big Four,' have either maintained their superior performance or at least improved them. The remaining of the paper discusses on the two remaining concerns often raised regarding the newly privatized firms. That is, the issue of desired corporate ownership structure and the role of government.

As for the first issue, we try to provide a number of reasons why *chaebols* are not appropriate candidates to acquire newly privatized firms. One argument is that the ownership structure of Korean *chaebols* suffers from a number of incentive problems: other people's money agency problem, entrenchment agency problem, and tunneling. Related to this, we show that there is a considerable separation between the control and cash flow rights in *chaebol*-affiliated firms, and introduce empirical literature showing the link between separation and firm performance.

As for the second issue, we strongly argue that the most important role a government could play after privatization is to make sure that the newly privatized firms are management independent of government interference. But, we also emphasize that government should improve the institutional environment that would induce better governance from Korean corporations. In this respect, we stress the importance of enforcement, protection of minority shareholders' right, and the role of institutional investors. To make domestic institutional investors to take a more active role in improving the governance of Korean corporations, we argue that the first step would be to revamp the governance structure of Korean National Pension Fund.

JEL: G23, G32, G34, L33

Keywords: privatization, ownership structure, corporate governance, institutional investors

* Professor, KDI School of Public Policy and Management, Chongyangri-Dong, Dongdaemun-Ku, Seoul, Korea 130-868. Tel: (+82-2) 3299-1183, fax: (+82-2) 3299-1240, e-mail: icnam@kdischool.ac.kr

** Assistant Professor, KDI School of Public Policy and Management, Chongyangri-Dong, Dongdaemun-Ku, Seoul, Korea 130-868. Tel: (+82-2) 3299-1030, fax: (+82-2) 968-5072, e-mail: wc_kim@kdischool.ac.kr

I. Introduction

As of May 2002, the Kim Dae-Jung administration completed the full privatization of four major public enterprises: Pohang Steel Co. (POSCO), Doosan Heavy Industries and Construction (Doosan H&C), Korea Tobacco and Ginseng (KT&G), and Korea Telecom (KT).¹ Except for Doosan H&C, the shares were deliberately sold to the general public so that no single shareholder can have a controlling interest in these firms. As a result, three former SOEs ended up having a dispersed ownership structure. Although not fully recognized, such form of privatization has a special historical meaning. This is because, up to that point, there was virtually no firm with a meaningful scale that had such a dispersed ownership structure. Until the privatization of 'Big Four,' only two types of ownership structure dominated the Korean corporate sector when it comes to large-scaled enterprises: either government-owned or *chaebol*-owned.

There were certainly criticisms against such ownership structure. It was argued that without any controlling shareholder, the privatized firms would be plagued with agency problems. It was suspected that professional managers would pursue their personal utility at the expense of shareholders.² This, however, does not mean that *Chaebol* families were generally considered as possible candidates to acquire privatized firms. The case of Doosan H&C was an exception. During and after the crisis, it was evident that *chaebol* firms had financial problems of their own. Also, the *chaebol* families did not have enough personal wealth to directly own such firms with the size of POSCO, KT, and KT&G. The only way they could possibly acquire a privatizing firm was by making the affiliated firms under their control to acquire it. But, more importantly, politicians and bureaucrats dropped the idea of *chaebols* owning privatized firms because of political reasons. The public sentiment was strongly against such option.

Although the 'Big Four' are fully privatized, it is not certain whether government wants to treat those firms as truly independent entities. This is particularly so for the three firms with dispersed ownership structure. Even if the government has no single share, in a number of ways, government can still influence such firms. There still exist heavy industry regulations by the line ministries. Also, the government can influence financial institutions, under government dominance, to vote against the management of newly privatized firms.

Although companies with dispersed ownership structure is prevalent and well accepted in

¹ This is in the order of their full privatization date.

² The failure of Kia Motors, which used to be major carmaker before the 1997 crisis, was often used as an example of such agency problem.

mature economies, it is a new venture in Korea. There are still doubts among the policy makers and even scholars of such corporate ownership structure. Such doubts are also believed to be delaying the privatization of remaining public enterprises, government-rescued banks, and a number of firms, banks acquired during the crisis period. Moreover, it is not well understood what the government role is in such privatized firms. Instead, there is a danger of government interference in management even after full privatization. Against this backdrop, the purpose of this paper is twofold. First, it reviews the developments that took place in the ‘Big Four’ after their full privatization. In particular, it examines their ownership and governance structures, and also reviews their financial performances. Second, the paper tackles the two major concerns regarding the newly privatized firms. That is, the issue of desired corporate ownership structure and the role of government.

To address the first issue, we try to provide a number of reasons why *chaebols* are not appropriate candidates to acquire newly privatized firms. To do so, we examine their ownership structure, their governance, and their performance. Although the method we adopted is *ad-hoc*, we believe that the message is clear. The second issue is addressed by going through the experiences of other countries that adopted golden shares, the most popularly used post-privatization control device. We also investigate what government can do to enhance the quality of corporate governance in Korea. Special attention is paid to enhance the role of institutional investors in Korea.

This paper is organized as follows. Part II briefly reviews the policy developments prior to the privatization of ‘Big Four.’ Part III reviews the developments that took place in the ‘Big Four’ after their privatization. Part IV examines the two remaining issues in newly privatized firms: the desired ownership structure and the role of government. Part V concludes.

II. Policy Developments Prior to the Privatization of Big Four

1. Early Years of Kim Young-Sam Administration

The first movement to privatize large public enterprises in Korea took place in 1994, when the Kim Young-Sam administration commissioned a comprehensive study of several public enterprises, including KEPCO, KT, POSCO, and KT&G.³ An interesting point is that the under-performance of SOEs was not a factor behind the push for privatization in Korea. All SOEs, subject to the study,

³ See Nam (2004) for details on the privatization process of large public enterprises in Korea.

except for Korea Heavy Industries & Construction, were very profitable.⁴ Nevertheless, the study generally concluded that a significant degree of efficiency loss existed due to their governance structures and that privatization would produce more efficient outcomes.

Despite such policy stance, it was not clear how to sell the controlling interests of such public enterprises. The possibility of handing over the controlling interests to *chaebols* was considered. But, policy makers soon dropped such an option, as it was politically infeasible with a widespread public sentiment against it. Selling the controlling interests to foreign investors was also excluded from consideration for a variety of reasons.

2. The Special Act on Privatization

The second movement toward privatization took place when the *Special Act on Privation* was enacted in 1997. Since government decided to take a more gradual approach in privatizing large public enterprises, there arose a question about the governance of those firms that would eventually be privatized during the period when the government remains as a major shareholder. The *Special Act on Privatization* was introduced to address such concerns.

The Act targeted four enterprises, KT&G, KT, KOGAS, and Korea Heavy Industries & Construction, and had two main features.⁵ First, it put restrictions on the ownership of all four public enterprises to prevent *chaebols* from acquiring controlling interests. Specifically, the Act required that the combined share of any investor, including the shares held by the parties who are in close relations with the investor, should not own above 15 percent in each of the four public enterprises.

Second, the Act prescribed an Anglo-Saxon type corporate governance system for the four public enterprises. The Act stipulated that the board must be consisted of only civilians, thus removing the presence of the line ministry as well as the Ministry of Finance and Economy.⁶ It also gave the board powers and responsibilities similar to those found in a typical board in U.K. or U.S. The Act even contained detailed procedures for electing CEOs, which aimed at guaranteeing transparency in the selection process.

⁴ Korea Heavy Industries & Construction was renamed in March 2001 as Doosan Heavy Industries & Construction after its privatization.

⁵ It is not clear why the Act did not include POSCO.

⁶ Previously, those public enterprises had boards consisted of a member from the line ministry, another from the Ministry of Finance and Economy, and the rest from outside the government. Before the merger between the Economic Planning Board (EPB) and the Ministry of Finance (MOF), the board member came from EPB.

3. Economic Crisis and The Privatization Plan of 1998

We have no doubt that the economic crisis in 1997/98 accelerated the privatization of large public enterprises in Korea. The Kim Dae-Jung administration, that assumed office at the peak of the crisis in February 1998, faced a number of factors that made privatization imperative. First, in the mid of the crisis, there was a political pressure from labor and *chaebols* alike that the government sector should also share the pain. It was generally acknowledged that SOEs had sizable room for improving efficiency, although they were in good financial health, unlike private firms. Second, some within the new administration expected that they would eventually have to sell SOEs to raise money to cover the costs of corporate and financial restructuring. There was also a need to raise foreign capital to increase foreign currency reserves.⁷

Consequently, the Budget and Planning Commission, a new government agency created by the new administration, announced an ambitious privatization and restructuring plan that covered 108 public enterprises. The 1998 plan classified public enterprises into three groups and prescribed different solutions for each. The first group was composed of 17 public enterprises and they were prescribed to be ‘completely privatized.’ The second group was consisted of 34 public enterprises and they were prescribed to be ‘gradually privatized.’ Lastly, the third group was composed of 27 public enterprises not to be privatized, but ‘restructured.’

4. Changes in The Privatization Plan of 1998

Initially, only POSCO and Korea Heavy Industries & Construction were included in the first group among the ‘Big Four.’ KT and KT&G were in the second group. But, during the implementation stage, government reclassified KT and KT&G to be fully privatized. The change in policy toward KT&G was related to the changes in government policy in the tobacco industry. The government abolished the statutory ban on entry into the tobacco manufacturing and the market was scheduled to be open to foreigners in late 2001. At the same time, the government also gave up the right to control KT&G’s cigarette prices.

The policy change toward KT came about as a result of an event that few had anticipated. In 1999, the government announced a plan to grant three licenses to operate G-3 mobile services, usually called IMT-2000 in Korea. The announcement triggered mobile operators into an intriguing game of mergers and acquisitions. Shinsegi and Hansol ended up offering themselves

⁷ This can be done by selling the shares to foreign investors.

as targets for M&A. SK Telecom successfully acquired Shinsegi Telecom. Korea Telecom Freetel (KTF), a subsidiary of KT, and LG Telecom, affiliated to the LG group, competed fiercely to acquire controlling interests of Hansol. Criticism emerged against such move by KT for it was not even classified by the government as an enterprise to be privatized. Government had to make a decision whether or not to allow such a bid. At the end, the government decided to allow KT to make a bid on the ground that failure to do so would cause serious damage to the competitiveness of KT and its market value. Thus, KTF offered more attractive terms than LG Telecom and eventually bought 44.1 percent of Hansol shares. This is probably the first case ever for a public enterprise to voluntarily acquire a major private firm that was not bankrupt. With this incident, it was decided to accelerate KT's privatization, and it was regroup into the first category of public enterprises soon to be privatized.

5. Divestures of Government Shares

Since then, the government shares of 'Big Four' were gradually divested. *Table 1* shows the details of how government divested the shares since 1998. *Table 2* shows the revenue collected from such divestiture effort.

Prior to 1998, government and Korea Development Bank (KDB), a wholly owned bank by the government, held 33.6 percent of POSCO shares. By October 2000, government and KDB divested all their shares. Government sold POSCO shares mainly by issuing depositary receipts (DR) to foreign investors. The remaining shares were sold to POSCO as treasury stocks. Industrial Bank of Korea (IBK), an indirectly owned bank by the government, however, still owns 2.34 percent of POSCO shares as of December 2002.

Korea Heavy Industries & Construction used to be owned by KEPCO and KDB, with 40.5 percent and 31.2 percent, respectively. The government fully controlled Korea Heavy using its dominant position in the two public enterprises.⁸ In October 2000, the Korea Heavy was listed in the Korea Stock Exchange and sold 14 percent of the shares to the investment public. Ten percent of the shares were sold to the employee stock ownership association (ESOA).⁹ Later in December 2000, 36 percent of Korea Heavy shares were sold to Doosan Co., which became the controlling shareholder of Korea Heavy. Korea Heavy was renamed as Doosan Heavy Industries &

⁸ Korea Exchange Bank (KEB) also owned 15.7% of the shares.

⁹ ESOA is different from a typical ESOP found in the U.S. Most of the funding source comes from the employees and the ESOA participants can receive payments within a short period of time (e.g. five years).

Construction in March 2001. Unlike, the other three public enterprises, Korea Heavy was sold to a *chaebol* group. Part of the reason was that Korea Heavy was not in a good shape to be sold in the public market. Its net income recorded (-) KRW 25 billion during FY2000.¹⁰ Also, government failed to find a candidate abroad.

Government's share in KT&G was close to 100 percent before the onset of the crisis. Its ownership, however, kept decreasing after the crisis as a result of a series of government investments in several banks using the KT&G shares.¹¹ The purpose of such investment was to increase the BIS ratios of those banks. By October 2001, government divested all its shares by initial public offering (IPO), issuing DRs, and exchange bonds (EB). Industrial Bank of Korea still holds 10.93 percent of KT&G shares as of December 2003.

Prior to 1999, government held 71.2 percent of KT shares. Government used a variety of methods to sell KT shares. KT shares were sold to foreign investors by issuing DR, EB, and bonds with warrant (BW). Domestic tender offers were also arranged. An interesting incident, however, took place in May 2002 when government arranged a domestic tender offer. SK Telecom acquired 11.34 percent of KT shares and became the largest shareholder of KT.¹² KT obviously did not welcome the acquisition as it appeared as a potential takeover threat. Government also opposed the acquisition as it could worsen the market concentration by SK Telecom. The controversy was settled when KT and SK Telecom engaged in two consecutive equity swaps in Dec. 2002 and in Jan. 2003.¹³

III. Developments After the Privatization of Big Four

In Part III, we go over the developments that took place in the 'Big Four' after their full privatization. In particular, we examine their ownership and governance structures, and also review their financial performances. Special attention is given whether the policy objectives, initially set before privatization, are met. Such policy objectives can be summarized into three. First, it was expected that the 'Big Four' would enhance its operational efficiency, and hence improve its market value. Second, it was expected that the 'Big Four,' in particular POSCO, KT, and KT&G, would have a dispersed ownership structure with an Anglo-Saxon type governance structure, and outside institutional investors monitoring the management. Third, it was expected

¹⁰ This amounts to over USD20 million

¹¹ This amounted to 19 percent of total shares

¹² To be exact, it was 9.55 percent of shares and 1.79 percent of EB.

¹³ KT was holding 9.7% of SK Telecom shares.

that labor would not exert excessive power, giving more room for management to exhibit strong leadership.

1. Ownership Structures of Big Four

Table 3 shows the ownership structure of ‘Big Four’ as of December 2002. We can make four observations. First, except for Doosan Heavy Industries & Construction, there exists no controlling shareholder in each company. The largest shareholder and its related parties own 3.97, 10.76, and 6.39 percents of POSCO, KT&G, and KT shares, respectively as of December 2002.¹⁴ Moreover, Brandes Investment Partners, Industrial Bank of Korea, and National Pension Corporation have no intention to control the company. This is consistent with the intention government had before their privatization. Government’s objective was for the newly privatized firms to have a dispersed ownership structure with a professional manager monitored by outside shareholders.

Second, except for Doosan Heavy Industries & Construction, foreign shareholders own a significant fraction of each company shares. Foreigners own 61.46, 27.01, and 44.39 percents of POSCO, KT&G, and KT shares, respectively as of December 2002. These figures are even higher in recent months. As of January 2004, foreigners own 67.14, 40.58, and 46.84 percents of POSCO, KT&G, and KT shares. The 46.84 percent foreign ownership in KT is impressive given that foreigners can own only up to 49 percent of KT shares. Table 4 shows the major shareholders of POSCO.

Third, each company holds a significant fraction of treasury stocks. As of December 2002, treasury stocks take up 9.96, 17.89, 34.10, and 25.49 percents of POSCO, Doosan H&C, KT&G, and KT shares. This is partly because of the way government divested its shares. As one can see in Table 1, stock repurchase was used as a method of divesting government shares for POSCO and KT&G. It should also be noted that the Commercial Code does not allow voting rights for treasury stocks, which means other shareholders in effect have a much higher voting power.¹⁵ Fourth, although government no longer holds the ‘Big Four’ company shares directly, they do hold some fraction indirectly. In case of POSCO, Industrial Bank of Korea (IBK) holds 2.34 percent of POSCO shares. As for Doosan H&C, Korea Development Bank and IBK hold 28.34 percent of its

¹⁴ Notice that we are using the June 2003 figures for KT. Until January 2003, SK Telecom held an 11.34 percent share of KT (including the EB).

¹⁵ For example, although IBK holds 10.75 percent of the KT&G shares, its voting power is 16.3 percent.

shares. In case of KT&G, IBK and Daehan Investment Trust Management holds 18.21 percent of KT&G shares. As for KT, National Pension Fund holds 2.7 percent of KT shares.

2. Governance Structures of Big Four

A. POSCO

POSCO has eight outside directors in a 14-member board. This 57 percent outside director ratio is higher than the 50 percent statutory requirement.¹⁶ POSCO also does not have a staggered board. Two of its subcommittees, the Audit Committee and the Director Candidate Recommendation & Evaluation Committee, are exclusively composed of outside directors, which again exceed the statutory requirements of two-thirds and one-half.¹⁷ POSCO is also one of the very few companies that have a subcommittee (Director Candidate Recommendation & Evaluation Committee) that deliberates executive performance evaluation and their compensation. This committee also approves the qualification of a candidate for an executive director position.¹⁸

Although the governance standards maintained by POSCO is well above any average listed company in Korea, there are still some rooms for improvement. First, POSCO needs to be more transparent about its CEO succession plan, how it evaluates the executives, and how it compensates them.¹⁹ Although the Director Candidate Recommendation & Evaluation Committee is established to deliberate on such issues, nothing is disclosed to outside shareholders. When a company has a controlling shareholder, like Korean *chaebols*, a controlling shareholder would closely evaluate the performance of executives, and compensate them accordingly. Also, in such ownership structure, there is not need for a CEO succession plan. CEO position is either handed over to his/her son/daughter or granted to the professional manager whomever the controlling shareholder prefers. But, there is no such mechanism when the company is widely held by a large number of small shareholders like POSCO. Thus, POSCO should establish and disclose its CEO succession plan and its policy toward executive performance evaluation & compensation. This

¹⁶ According to the *Securities and Exchange Act*, Korean listed companies, with book asset value greater than 2 trillion won, must have at least 50 percent outside director ratio. The 'Big Four' companies are all above the 2 trillion won threshold.

¹⁷ As for firms with book asset value above the 2 trillion won threshold, two-thirds of the audit committee members should be outside directors, and one-half of outside director nomination committee must be outside directors.

¹⁸ It is the board, not the committee, however, that makes the final recommendation to the shareholders.

¹⁹ This is a common practice in Korea. As for executive compensation, listed companies disclose only the aggregate amount paid to the board as a whole, and do not disclose the payment for each individual director.

will also be helpful to prevent any possible interference from the government on CEO succession issues.

POSCO should also consider having an independent Board Chairman. Currently, the CEO assumes the role of Board Chairman.²⁰ A clear division of responsibilities between the CEO and the Board Chairman, however, is a precondition before such separation. If it is too premature, POSCO should at least elect a lead outside manager who would preside the meeting exclusively composed of outside directors. This is very important to restraint the power of CEO when there is no counterforce.

POSCO should also consider allowing 'vote by mail' or 'vote by Internet.' This is particularly important to foreign investors who cannot attend the AGM in person or find someone in Korea to attend the AGM on their behalf. These concerns also apply to small domestic investors. POSCO should also consider allowing cumulative voting when it comes to electing directors.²¹ Currently, POSCO excludes the adoption of cumulative voting by its Articles of Incorporation. Even though POSCO does not have a controlling shareholder, which reduces the potential benefit from cumulative voting, we still believe it is valuable to adopt it. This is because, even without a controlling shareholder, the management can usually secure a much larger fraction of votes than the opposing outside shareholder when it comes to proxy solicitation.

POSCO should also revamp a couple of anti-takeover measures it has adopted. According to its Articles of Incorporation, POSCO can issue preferred shares convertible to common shares.²² The problem with such convertible shares is that it can be issued in advance to friendly investors and later, when a hostile take-over attempt takes place, be converted to common shares to support the incumbent management. POSCO is also criticized for making use of pseudo cross-shareholding to protect itself from outside takeover attempts. According to the Center for Good Corporate Governance (CGCG), POSCO donated KRW 30 billion in 1999, and KRW 300 billion in 2000 to Pohang University, and it is believed that Pohang University used about KRW 200 billion of the donation to buy the POSCO shares.

POSCO has also been steadily increasing the number of affiliated firms. According to the Korea Fair Trade Commission, POSCO has 15 affiliates as of April 2003. Most of the affiliated

²⁰ We, however, also acknowledge that during the few years after its full privatization, POSCO needs a strong leadership to management the company independent of governance interference, which makes it undesirable to split the leadership by having an independent Board Chair.

²¹ The *Commercial Code* in Korea allows companies to adopt cumulative voting. But, it also allows companies to exclude its adoption by articles of incorporation. Thus, most companies in Korea, including POSCO, exclude the adoption.

²² See Article 8 (Number and Contents of the Convertible Preferred Shares) of the POSCO AOI.

firms, however, are unlisted. Only three, including POSCO, are listed.²³ Increasing the number of listed firms raises a concern because it is the very practice *chaebol families* adopted to have control over a large number of firms with only a small amount of their personal equity investment.

B. Doosan Heavy Industries and Construction

Doosan Heavy Industries & Construction is an affiliate to a *chaebol* group named Doosan. Mr. Park Yong-Oh is the current Group Chairman. As of March 2003, the Doosan group is the 11th largest *chaebol* group in Korea in terms of its asset size.²⁴ According to the Korea Fair Trade Commission, the Doosan group has 22 affiliated firms. Among the 22 firms, four are listed in the Korea Stock Exchange (KSE) and one is registered at the KODAQ Stock Market.²⁵

Doosan H&C has equal number of outside and executive directors. That is, eight outside directors and eight executive directors, just enough number of outside directors to meet the statutory requirement. Among the eight executive directors, three are relatives of Chairman Park. Among the eight outside directors, four are not truly independent: one is an ex-manager of Korea Heavy; two are ex-managers of KEPCO, which owned a controlling interest of Korea Heavy before its privatization; and one is an ex-manger of Korea Exchange Bank (KEB), which also used to hold significant shares of Korea Heavy.²⁶ Doosan H&G excludes the adoption of cumulative voting by its Articles of Incorporation. It also does not allow voting by mail or voting by Internet. It also does not have a compensation committee, let alone disclose the compensation level of its individual directors. The COE assumes the Board Chairman position.

C. KT&G

The most unique feature of KT&G's governance structure is that it elects the company President (CEO) by open competition. The President Recommendation Committee evaluates the candidates that applied for the post and select a nominee whose approval would be voted at the AGM. If

²³ Pohang Coated Steel Company is listed in the Korea Stock Exchange (KSE) and POSDATA Company is registered at the KOSDAQ Stock Market.

²⁴ The top ten includes Samsung, LG, SK, Hyundai Motors, Hanjin, Lotte, Hanwha, Hyundai Heavy Industries, Hyundai, and Kumho.

²⁵ The four listed firms include Doosan, Samhwa Crown & Closure, Doosan Heavy Industries & Construction, and Doosan Construction & Engineering. Oricom is registered at the KOSDAQ Stock Market.

²⁶ It is also well known that there exists a significant amount of business transaction between Doosan H&C and KEPCO.

approved, the President serves a three-year term. *Special Act on Privatization* required such scheme when KT&G was not fully privatized. KT&G kept this scheme even after its full privatization. The President Nomination Committee, an *ad hoc* committee working under the Board, is consisted of outside directors and the President.²⁷ Total number of members cannot exceed seven.²⁸

Another important feature of KT&G's governance structure is that it has the Management Evaluation & Compensation Committee. This committee, composed exclusively of outside directors, is authorized to set up the standards for President nomination. It also reviews the management agreement signed between the President candidate and the Chairman of the President Recommendation Committee. It also reviews the performance of the President and can propose his/her dismissal if it determines that the President failed to achieve the management goals set out in the management contract. KT&G also has a Public Welfare Committee, which is authorized to prepare and propose the company's mission statement and the ethics code for directors. The committee also reviews important policy matters regarding the protection of consumers, leaf tobacco farmers, and employees. The Public Welfare Committee is solely composed of outside directors. The Management Evaluation & Compensation Committee and the Public Welfare Committee, however, are not mandated by the KT&G Articles of Incorporations.

KT&G also has a high outside director presence in its Board and the subcommittees. As of March 2003, KT&G had three executive directors and ten outside directors. This is a 77 percent outside director ratio. The Outside Director Nomination Committee is consisted of four outside directors and one executive director. The Audit Committee is composed of three outside directors and one executive director. KT&G also requires outside directors to meet twice a year without the presence of executive directors. The adoption of cumulative voting is also not excluded by the Articles of Incorporation. KT&G has only one affiliated firm, Korea Jinseng Corporation, which is 100 percent owned by KT&G.

Like POSCO, KT&G does not disclose the compensation level of its President and each individual director. Only the aggregate paid to the whole Board is disclosed. This is the practice despite the fact the Chairman of the President Recommendation Committee enters a management contract with the President candidate. Another point that should be made about KT&G's governance structure is that its Articles of Incorporation has been revised to make the director dismissal difficult. According to Article 20 of the KT&G AOI, to dismiss a director, there must be

²⁷ If the incumbent President wants to be re-nominated, he/she cannot be a member.

²⁸ Detailed provision regarding the President Recommendation Committee can be found in Article 32 in the KT&G Articles of Incorporation.

an approval by two-thirds of the participating shareholders and majority of the total outstanding shares. This is a tougher threshold than the one that is in the *Commercial Code*. The Code requires approval by two-thirds of the participating shareholders and one-fourth of the total outstanding shares. KT&G also does not have an independent Board Chairman, nor does it have a lead director. Like POSCO, KT&G can also issue convertible preferred shares, which can be used as an anti-takeover measure.

D. KT

Along with KT&G, the most unique feature of KT's governance structure is that it elects the company President (CEO) by an open competition. Candidates for President apply for the post, and the President Recommendation Committee nominates a candidate to be voted for approval at AGM. Such scheme was adopted under the *Special Act on Privatization* before KT's privatization, but even after its full privatization, KT holds onto such scheme.²⁹ The Articles of Incorporation of KT stipulates on the composition of the President Recommendation Committee and the factors to be considered when setting forth the candidate evaluation standards.³⁰ A separate independent committee, composed solely of outside directors determines the standards.

Another important feature of KT's governance structure is that the Candidate for President submits his/her employment contract to AGM.³¹ In effect, CEO compensation is also disclosed to the shareholders.³² The President Recommendation Committee and the Candidate signs the contract. Later, the Board may conduct a performance review to determine whether the elected new President has performed his/her duties under the contract. The results of such performance review must be reported to the shareholders at AGM. When the Board determines that the President has failed to achieve the management goal agreed under the contract, it may propose to dismiss the President at AGM.

The presence of an independent Board Chairman is another important feature of KT's governance structure. Board Chairman has a one-year term. The outside director ratios of KT's

²⁹ KT's Articles of Incorporation has detailed provisions regarding the election process (Article 25, 32, and 33).

³⁰ The President Recommendation Committee is composed of five members: three outside directors; one designated by the Board among the former Presidents or the incumbent President; and one civilian appointed by outside directors.

³¹ Detailed provisions in the Articles of Incorporation can be found in Article 34

³² The current President, Young-Kyung Lee receives a base salary of KRW 276 million, an incentive bonus up to 200 percent of the base salary, and a stock option for 300,000 underlying KT shares that was granted in December 2002.

subcommittees also exceed the required ratio set by the *Securities and Exchange Act*. As of March 2003, the KT board is composed of nine outside directors and five executive directors, making the outside director ratio 64 percent, which is well above the statutory requirement.³³ The Outside Director Candidate Recommendation Committee is consisted of one executive director and four outside directors. The Audit Committee is composed of three outside directors. KT also did not exclude the adoption of cumulative voting by its Articles of Incorporation. Thus, KT shareholders can make use of cumulative voting to elect their directors. KT's outside directors have a staggered term of office. According to KT's Articles of Incorporation, one-third of the outside directors shall be elected each year. Such staggered system, however, does not exist for executive directors.

The major problem with KT's governance structure is that its outside directors are mostly composed of ex-government officials. Out of seven outside directors, five are either ex-government officials or retired research fellows from government think tanks. It even includes an ex-Vice Minister from the Ministry of Information and Communication (MIC), the line Ministry, which regulates the industry KT is active. To manage KT independent from government, it is strongly recommended to replace the current outside directors with those who are not only independent from management, but also from government. KT should also adopt voting by mail and voting by Internet to facilitate voting by foreign investors and small domestic investors. KT also has been increasing the number of its affiliates. As of April 2003, KT has ten affiliated firms, four of which are listed.³⁴

It should also be noted that the labor union of KT has been keen on nominating a director candidate. According to the *Securities and Exchange Act*, shareholders owning at least 1 percent of shares can propose a director candidate to the board. Once such proposal is submitted, the Outside Director Recommendation Committee must nominate the candidate to be voted at AGM. As of December 2002, the employee stock ownership association (ESOA) of KT holds 6.62 percent of total shares. Although a candidate nominated by the labor union may facilitate the relationship between labor and management, there is also a danger that he/she could represent the interests of labor at the expense of other stakeholders, especially the shareholders.

3. Financial Performance of Big Four

³³ As of January 2004, however, KT has seven outside directors, and five executive directors.

³⁴ Among the four, KT is listed in the Korea Stock Exchange (KSE) and KTHitel, KT Submarine, and KTF are registered at the KOSDAQ Stock Market.

This section reviews the financial performance of ‘Big Four.’ We examine their profitability, market value, and share return against a number of benchmarks before, during, and after the privatization. For a number of reasons, however, the analysis is severely limited. First, only two years have passed since the full privatization of KT, which was the last to be privatized among the ‘Big Four.’ This made the sample period after full privatization too short to conduct meaningful analyses. Second, some firms became a public company only during the privatization process, which means that we cannot obtain share return and market value data during the pre-privatization period. Third, as former SOEs, they may have enjoyed a certain degree of monopoly power even after their privatization, which gives an upward bias in their profitability measure.³⁵ Fourth, privatization took place immediately after the economic crisis of 1997/98, which further complicates the analyses. As such, we do not intend to extract a definitive conclusion from these analyses.

A. Profitability

Table 5 shows the EBIT/Asset measure of ‘Big Four’ from 1996 to 2002. We use EBIT instead of net income, since EBIT is a better indicator of operational efficiency. Since this data is not available during the period they were unlisted, we have a number of missing observations in earlier periods. We also show the industry averages for comparison. Industry averages are computed by equally weighting the EBIT/Asset measure of those firms with the same 6-digit industry code according to the Korea National Statistical Office’s industry classification.³⁶ The ‘Big Four’ are not included when computing industry averages. We also dropped those firm-years when there is a change in the fiscal year, as it would distort the EBIT measure. Also notice that year-end book asset values are used instead of beginning-of-the-year book asset values.³⁷

In case of POSCO, Table 5 shows that it has maintained its high profitability even after its full privatization in October 2000. POSCO’s comparison group, firms in the manufacturing of basic iron and steel industry, shows a poor performance relative to POSCO throughout the period. In case of Doosan Heavy Industries & Construction, the picture is reverse. Although, Doosan Heavy’s profitability improved after its full privatization in December 2000, it is still behind its

³⁵ This point, however, is certainly not the case for KT, which had to compete with SK Telecom in the mobile communications business. In the mobile communications business, SK Telecom has the largest market share.

³⁶ We only include those firms listed in the Korea Stock Exchange (KSE). This is legitimate since other firms are not comparable to the size of ‘Big Four.’

³⁷ This is to increase the number of observation, which is already small.

comparison group (firms in the manufacturing of general purpose machinery). In case of KT&G, we can see that its profitability is high and also improving since its full privatization in October 2001. Notice that there is no comparison group in Korea for KT&G. In case of KT, we can see that its profitability has been improving during its privatization period. But, its profitability is lower than its comparison group composed of SK Telecom and Dacom, throughout the period. This is partly because of the monopoly power enjoyed by ST Telecom in the mobile communications business that boomed during the sample period. Overall, the picture is encouraging. The profitability of POSCO is above its industry average, and the profitability of Doosan H&C, KT&G, and KT are also improving.

B. Market Value

Market value is computed by *Tobin's Q*, which is defined as market value of asset over book value of asset. Given the difficulty of obtaining the market value of debt, and following the convention in the literature, we proxy the market value of asset by 'market value of total equity plus book value of debt.' Since the market value of preferred share is minimal, we replace 'market value of total equity' by 'market value of common equity.' Notice that we do not drop any firm that changed its fiscal year during the sample period, since it would not bias the *Tobin's Q* measure. Year-end closing prices are used to compute the market value of common equity. Industry averages are computed by equally weighting the *Tobin's Q* measure of those firms with the same 6-digit industry code following the Korea National Statistical Office's industry classification. The 'Big Four' are not included when computing industry averages. Table 6 shows the result.

The low figures in 1997 reflect the market crash during the currency crisis, and the high figures in 1999 reflect the stock market bubble during the IT boom. In case of POSCO, the *Tobin's Q* after its full privatization in October 2000 is higher than the *Tobin's Q* before the announcement of the 1998 privatization plan. Moreover, POSCO's *Tobin's Q* is always higher than the industry average since 1999. Before the announcement of the 1998 privatization plan, POSCO's *Tobin's Q* was lower than the industry average. In case of Doosan H&C, there is no sign of improvement and the figures are always below the industry average. In case of KT&G, the figure is high, and maintained since its full privatization. In case of KT, the figure is always behind the industry average. But, the gap has been shrinking in recent years. The overall picture is that the 'Big Four,' except for Doosan H&C, are highly valued in the market, and not necessarily behind their respective comparison groups.

C. Share Return

To examine the ‘Big Four’s share return, we use the adjusted share return figures. That is, returns adjusted for dividend, stock-splits, stock-mergers, discounted new issuances, and so on. Using this adjusted return, we compute daily averages during three sub-periods: before, during, and after the privatization. We do not conduct any event study, as there is no clear event date.³⁸

Table 7 shows the share return of ‘Big Four.’ In case of POSCO, throughout the period, its share returns are above any benchmark. Notice that the industry-adjusted excess return, however, is decreasing over time. In case of Doosan H&C, returns are negative during the privatization period. But, stock price movement reversed after its full privatization, and its excess returns are positive against any benchmark. In case of KT&G, excess return is negative during and after the privatization. In case of KT, excess return computed against the industry index is negative during the privatization period. However, stock price movement reversed after its full privatization, and its excess return became positive. Overall, this picture is consistent with that shown in Table 6. Highly valued firms even before their full privatization, such as POSCO and KT&G, show a pattern of declining returns relative to the benchmark. On the other hand, Doosan H&C and KT, the values of which were relative low compared to the industry comparables at the time of privatization, gained higher returns after their full privatization.

IV. The Two Remaining Issues

1. Desired Ownership Structure

When policy makers drafted the *Special Act on Privatization* in 1997, they deliberately designed the *Act* so that no *chaebol* can acquire a controlling interest in any of the ‘Big Four.’ During the privatization process, however, Korea Heavy Industries & Construction was sold to a *chaebol* group. Also, during the last stages of KT’s privatization, SK Telecom once became the largest shareholder of KT. Notice that SK is the third largest *chaebol* group in Korea as of April 2003.

These incidents indicate that there exists some possibility of *chaebol* acquiring large public enterprises in Korea. Furthermore, three of the ‘Big Four’ are no longer subject to statutory

³⁸ As shown in the previous sections, privatization of ‘Big Four’ was completed over an extended period of time.

ownership limits. The exception is KT, where foreign investors cannot collectively own above 49 percent, and individually above 3 percent. But, there is no ownership restriction applied to domestic investors even for KT. Thus, there is always a possibility for a *chaebol* to takeover one of the 'Big Four,' or acquire a public enterprise that has not been privatized yet, such as KOGAS or KEPCO, upon their privatization. As such, the issue of desired ownership structure for newly privatized firms is still an important policy issue. In this section, we try to provide a number of reasons why *chaebols* are not appropriate candidates to acquire newly privatized firms.

A. Conceptual Framework

The ownership structure Korean *chaebol* is conceptually the worst of its kind. The corporate finance literature often compares two types of ownership structure: the one with dispersed ownership, and the other with concentrated ownership. It is well known that both ownership structures have problems of their own. In the case of dispersed ownership, a professional manager is likely to pursue his/her own utility at the expense of shareholders' interest. But, he/she cannot be entrenched. If the manager under-performs, the market for corporate control would kick in, and would oust him/her. In the case of concentrated ownership, the controlling shareholder's interest is well aligned with those of outside shareholders. But, he/she is likely to be entrenched. That is, even when he/she under-performs, the controlling shareholder would not be voted out.

The problem with the *chaebol* ownership structure is that it combines the incentive problems associated with both the dispersed ownership structure and the concentrated ownership. This is because the *chaebol* family ingeniously makes use of pyramids and cross-shareholding schemes to artificially inflate its control right well above its cash flow right. Under such ownership structure, there would be many affiliated firms where the *chaebol* family would not own a single share, but exercise full control through a set of affiliated firms that do hold the shares.³⁹ Thus, *chaebol* firms suffer from the agency problem as the family holds only a fraction of shares, especially those at the low tiers of the pyramid. At the same time, they suffer from the entrenchment problem, as the family is protected from any takeover attempt thanks to the cross-shareholdings of group-affiliated firms.

³⁹ This point has been made in a number of existing papers. For example, Bebchuk et al. (2000) compares three corporate ownership structures: controlled structure (CS), dispersed ownership (DO), and controlling minority structure (CMS). According to Bebchuk et al. (2000), Korean *chaebols* would be classified as CMS. Morck and Yeung (2003) distinguish three types of agency problem: other people's money agency problem, entrenchment agency problem, and tunneling. They argue that family firms, like Korean *chaebol* firms, are plagued by three agency problems at the same time.

On top of all this, the *chaebol* ownership structure suffers from another type of agency problem. That is, wealth transfers from one affiliated firm to another, often known as tunneling. Tunneling is a problem since it infringes upon the interest of outside shareholders in firms, whose wealth has been transferred to another. But, the *chaebol* family members have strong incentive to do so since they have cash flow claims not only to a single company, but also to many others under their control. They are more interested in maximizing the group's interest as a whole, rather than the interest of each individual affiliated firms.

B. Control-Ownership Disparity of Korean *Chaebols*

Korean *chaebols* do have a significant degree of disparity between control and cash flow rights. Table 8 shows the evidence. The tables shows that the average disparity is 18.8 percent, meaning that a typical *chaebol* family would control 18.8 percent more votes than they actually own.⁴⁰ In case of Hanhwa group, the disparity is over 50 percent. Table 9, one the other hand, shows the disparity computed for POSCO, KT, KT&G, and some other large public enterprises. It clearly shows that the levels of disparity are significantly lower than those of *chaebols*.

The computation of disparity, however, needs some explanation. To compute a group level disparity, we first have to compute the disparity in each firm that comprises the group. As for an individual firm, the controlling shareholder's cash flow right in company A is defined by the direct and indirect shareholdings in company A by the controlling shareholder and its related parties. Related parties include only the immediate relatives defined by the *Monopoly Regulation and Fair Trade Act*. If controlling shareholder holds 50% of company B shares, and company B holds 50% of company A shares, the controlling shareholder's indirect shareholding in company A would be 25%.⁴¹ On the other hand, the controlling shareholder's control right in company A is defined by the direct shareholdings in company A by the controlling shareholder, its related parties, and the affiliated firms. Each month, the Fair Trade Commission identifies the affiliated firms. Related parties include not only the immediate relatives, but also top executives of company A and non-profit organizations affiliated to the controlling shareholder. Once the disparity measure is computed for each firm, we can compute the group-level disparity by the weighted average of

⁴⁰ The table includes large business conglomerates subject to a certain set of regulations by the Korea Fair Trade Commission. The regulations include ban on mutual shareholdings and the ban on mutual debt guarantees.

⁴¹ It requires some matrix operation to compute indirect shareholding if company A shares are owned by multiple affiliates, and those multiple affiliates are again owned by another set of affiliates, and so on.

individual firm's disparity. Book equity is used as the weight. All the necessarily data was provided by the Korea Fair Trade Commission.⁴²

C. Disparity and Firm Performance: Empirical Link

It has been empirically proven that such separation between control and cash flow rights can lower firm performance. For example, Claessens, Djankov, and Lang (2000) document the separation of ownership and control in nine East Asian countries and show that such separation is most pronounced among family-controlled firms. In their study of eight East Asian countries, Claessens, Djankov, Fan, and Lang (2002) show that firm value falls when the control rights of the largest shareholder exceed its cash-flow ownership, consistent with the entrenchment effect. Another line of research investigates the performance of East Asian firms during the crisis. In their study of eight East Asian countries, Lemmon and Lins (2003) show stock returns of firms in which managers have high levels of control rights, but have separated their control and cash flow ownership, are significantly lower than those of other firms during the crisis period.

There are also a number of Korea specific papers studying the behavior of *chaebols*. For example, Joh (2003) shows that firms affiliated to a *chaebol* group experienced lower operational profits during the pre-crisis period. Baek, Kang, and Park (2003) and Kim and Lee (2003) show that this was also the case for stock price performance during the crisis period. Campbell and Keys (2003) also show that firms affiliated with the top five *chaebols* exhibit significantly lower performance and significantly higher sales growth relative to others during the 1993-1999 period. Jung and Kwon (2002) look at earnings informativeness instead of firm performance. They show that in *chaebol* firms, as opposed to non-*chaebol* firms, no significant relationship is found between the largest shareholder's holdings and earnings informativeness.

Some papers examine the tunneling problem more closely. Bae, Kang, and Kim (2002) show that when a *chaebol*-affiliated firm makes an acquisition, its stock price on average falls, but the market value of other firms in the group rises. This evidence tells that while minority shareholders of a *chaebol*-affiliated firm making the acquisition loses, the controlling shareholder of that firm on average benefits. We can find such evidence in the internal capital market studies too. For example, Shin and Park (1999) show that investment-cash flow sensitivity is low and insignificant for *chaebol* firms but is high and significant for non-*chaebol* firms. They also show that a *chaebol* firm's investment is significantly affected by the cash flow of other firms within the same *chaebol*

⁴² Because of the agreement with KFTC, the raw data cannot be disclosed at the time of this writing.

group even though they are independent legal entities.

Table 9 shows the financial indicators of ‘Big Six,’ namely ‘Big Four’ plus KEPCO and KOGAS. They are compared with all other listed companies. Given that these remaining firms are family firms, and mostly *chaebol* firms, the table indirectly compares the performance of Big Six versus *chaebols*. It shows that, overall, the Big Six outperforms the rest in terms of profitability (net income to stockholders’ equity ratio) and financial soundness (interest coverage ratio and debt to equity ratio).

D. Corporate Governance

In Korean *chaebols*, the controlling family members are not mere investors, they involve heavily in the management of the firms under their control. They involve in management as group chairman, board chairmen, CEOs or senior executives. The problem with this is that they are entrenched managers, which makes it hard to introduce high standards of corporate governance into *chaebol* firms.⁴³ Because they have low possibility of being removed by outside hostile investors, they have no incentive to restrain their own power to engage in tunneling or other activities that might infringe upon minority shareholders’ interest.⁴⁴

One piece of evidence is the comparison between Doosan Heavy Industries & Construction with the rest of ‘Big Four.’ As described in Part III, the internal governance structure of Doosan Heavy Industries & Construction falls behind those of POSCO, KT, and KT&G. Recent executive turnover and compensation papers also show some evidence. Using data between 1993 and 1999, Campbell and Keys (2003) show that top executive turnover in firms affiliated to top five *chaebols* is unrelated to firm-level performance. On the other hand, they show that managers of firms unrelated to the top five *chaebols* are significantly more likely to lose their job when performance deteriorates. In their study of pay-performance sensitivity, Takao, Kim, and Lee (2003) find evidence that non-*chaebol* firms structure their executive compensation so as to reward their executives for improving shareholder value more so than *chaebol* firms.

The corporate governance rankings by professional rating service providers also show evidence that newly privatized firms or banks rank relatively higher than the *chaebol*-affiliated firms in Korea. Table 10 shows the top 10 companies in terms of their corporate governance qualities by

⁴³ Kookmin Bank, a recently privatized bank, is also known to have a high standard of corporate governance.

⁴⁴ One recent exception would be SK Corp. Sovereign Asset Management, a foreign investor, took a 14.99 percent equity stake in this company and has been requesting for higher corporate governance standards.

Credit Lyonnais Securities Asia (CLSA), which has been rating Asian companies since 2001. Despite the large number of family firms in Korea, their presence in the top 10 list is relatively small compared to newly privatized firms or banks, in which *chaebols* were restricted to own controlling interests. Also notice that KT and KT&G ranked 1st and 3rd in the most recent ranking.

E. Other Reasons

Other reasons have been raised against the acquisition of newly privatized firms by *chaebols*. For example, it was noted that *chaebol* families do not have enough personal wealth to acquire a controlling interest. Thus, it is understood that the most probable way for *chaebols* to acquire a newly privatized firm is through its existing firms. That is, further making use of the pyramids and cross-shareholding schemes. But, this will only worsen the ownership structure that is already in a bad shape. This is what actually happened in case of Doosan Heavy Industries & Construction. It was Doosan Corp, not the individual Doosan family members, who purchased a controlling stake. Leverage can also make the acquisition possible. By borrowing from banks or issuing corporate bonds, *chaebol* firms could secure enough capital to take controlling interests of newly privatized firms. But, this will only worsening the debt-to-equity ratio of Korean *chaebols*, which has been notoriously high, and contributed to the economic crisis of 1998.

Recent accounting and governance scandals of SK group and the illegal political donations from the top four *chaebol* during the last Presidential election also support the view that *chaebols* should not be considered as candidates to acquire newly privatized firms. Opponents are afraid that the former public enterprises that have grown with government support, and ultimately using people's tax money, would end up being used as vehicles to enrich the *chaebol* families after their privatization. In connection with this, it is argued that *chaebols* should not take controlling interests in financial institutions.

2. The Role of Government

The most important role government can play after privatization is to make sure that the newly privatized firms are managed independent of government interference. A mere transfer of ownership will not improve any efficiency. The framework of government regulation should also be revamped for newly privatized firms. It should rely on indirect measures, such as competition policies. The second role the government should play is to make sure that the market for corporate

control works effectively. Otherwise, the management would be entrenched or suffer from agency problems and would not bring the desired outcome policy makers originally intended. More broadly, government should make an external environment to induce good corporate governance from the newly privatized firms.

In reality, however, there are always temptations among government officials and the politicians to maintain their influence over newly privatized firms. As such, they may choose to 'partially' privatize instead of fully privatizing the public enterprises. As for fully privatized firms, they may try to hold shares with special power, such as golden shares. As in the case of KT, they may try to make privatized companies to appoint outside directors among ex-government officials.

In this section, we briefly discuss the experience of other countries that adopted golden shares, the most popular post-privatization control device. Next, we discuss the role government can play to enhance the governance standards in Korea. Special attention is paid to the role of institutional investors as a vehicle to enhance corporate governance.

A. Golden Shares

Golden shares are special control rights provided to the government in fully or partially privatized firms on national security or on other public policy grounds.⁴⁵ It usually gives a veto power to hostile takeover attempts. Golden shares were first introduced in U.K., and later widely spread to other OECD countries.⁴⁶ But, the extent of special rights provided to the government, the duration of those rights, and the conditions they can be activated varies across those countries. It is believed that golden shares can facilitate privatization. This is because, without such control device it would be politically difficult to privatize public enterprises with national interest. Golden shares may also offer more flexibility than limiting foreign ownership by legislation. This is especially so when the underlying public policy objectives are expected to be short-lived.

Golden shares, however, have drawbacks, and the recent trend shows that it is less favored. First, golden shares can be an impediment to improve the efficiency of privatized firms. If it is abused, it can serve as a tool for government intervention in company decisions. Also, with its existence, the market for corporate control would not function, entrenching the incumbent

⁴⁵ For more detailed discussion on golden shares and other post-privatization control devices, see OECD (2003).

⁴⁶ These countries include the Netherlands, Spain, Portugal, Belgium, New Zealand, Italy, the Czech Republic, Poland, Hungary, and Turkey. Mexico, Sweden, Switzerland, Australia, Germany, however, did not adopt golden shares.

management. It also creates investor uncertainty, which will dampen the share value. The experiences in OECD member countries suggested that the drawbacks associated with golden shares are closely linked to the scope of special rights granted, their duration, and the manner by which the rights have been exercised. So, when introducing a golden share, it is suggested to narrowly define the scope, limit the duration, and make sure it is not invoked arbitrarily. Evidence also shows that golden shares have rarely been exercised, but the existence itself served as a deterrent to takeovers.

Golden shares have also been a concern to the European Commission (EC). In 1997, the EC communicated its concerns to the member countries with respect to the control procedures requiring prior authorization for acquisition of the company shares. In 1998 and 1999, it brought infringement proceedings against six countries: UK, France, Belgium, Italy, Portugal, and Spain. Against the EC's concern, the member countries noted that the use of golden shares made privatization in certain sectors feasible. In June 2002, the European Court of Justice issued its ruling on the compatibility of golden shares with the EU treaty. In its ruling, the court allowed golden shares, but also set certain restrictions. The ruling permits only narrowly defined and limited golden shares. At the same time, it requires that the measure be proportionate to the objective that is being pursued.

We do not believe golden shares can be introduced in companies that are fully privatized. Any introduction of such special control right would be a grave infringement upon shareholders' right, and it would be regarded as a setback. If government wants to introduce golden shares, it should be done before privatization or for partially privatized firms. Even in this case, in light of the ruling made by the European Court of Justice on golden shares, the scope of special rights granted to the government should be narrowly defined, their duration should be limited, and not arbitrarily invoked.

B. Measures to Ensure Good Governance

With no apparent controlling shareholder closely monitoring the management, newly privatized firms with a dispersed ownership structure, like POSCO, KT, and KT&G, can suffer from the *other people's money agency problem*. To eliminate such problem and ensure good governance, these companies need to introduce a number of governance-related rules and procedures. Board should have truly independent outside directors, who would not only advice, but also monitor the management. In case of newly privatized firms, we emphasize that the outside directors should

also be independent from the government. Management should be evaluated and compensated by the compensation committee, exclusively composed of those independent outside directors. Compensation should be linked to long-term firm performance and disclosed so that outside shareholders can monitor the existence of pay-performance link. CEO succession plan should be established and disclosed so as to give no room for the government to interfere. Anti-takeover measures should be abolished, to prevent the incumbent management from entrenchment. Any attempt to protect former public enterprises from foreign acquisition should be done by law, not by anti-takeover measures adopted by incumbent management.

Such 'internal' effort, however, is not enough. The external environment is equally important to ensure good governance. Without effective penalties imposed or awards granted from the outside, firms would have no incentive to improve their governance practices. The absence of such external penalty-and-award system was probably the most compelling reason why Korea had to rely upon direct government regulation to improve the governance standards in the aftermath of the crisis. The external environment can be classified into three: enforcement, legal protection of minority shareholders, and institutional shareholder activism.

Enforcement refers to making the government supervisory institutions, such as the Financial Supervisory Service (FSS) and the Fair Trade Commission (FTC), the prosecutor's office, and the court more independent from the business sector. It also refers to giving those institutions enough statutory power that would allow them to investigate corporate wrongdoings. In the past, these institutions were reluctant to engage in investigation and were not strict in their law enforcement. They expressed worries that their corporate investigations and the subsequent penalties levied would damage the weakening economy and kill corporate entrepreneurship. In recent years, however, these institutions have shown change in their pro-business stance. In addressing the recent corporate scandals, the prosecutor's office, in particular, became more active and strict in their investigations.

Small individual shareholders are the most vulnerable. Although, they may individually own only a very small fraction of the outstanding shares of a company, the shares they hold might take up a significant portion of their personal wealth. Class action suit is probably the most effective tool to protect small shareholders. In December 2004, the Korean National Assembly passed a bill allowing for securities class action. Although, the scope of activities shareholders can file litigation against is limited, it is still considered to be a big step forward in the protection of minority shareholder's right.

C. Overview of Institutional Investors in Korea

The most lagging area in the external environment is the role played by institutional investors. According to the press release by the Korea Stock Exchange (KSE), Korean institutional investors in 2003 voted their proxies 'for' management 95.5 percent of the time. No domestic institutional investor filed a derivative lawsuit against a listed company, nor did they initiate a proxy fight. A number of points can be made why they are not active in exercising their shareholder's right.

First, Korean institutional investors are not long-term investors. According to the Korea Stock Exchange (KSE), the turnover ratio, computed by the ratio of shares traded during a year over the shares outstanding, is 498.06 percent for domestic institutional investors.⁴⁷ This is well above the market average of 248.86 percent in Korea. It means that domestic institutional investors, on average, hold onto the same share for only two and a half months. Foreign institutional investors trading in the Korean market hold shares relatively longer. Their average turnover ratio is 183.05 percent.

Second, domestic institutional investors hold only a small fraction of the Korean market. According to KSE (2003), the fraction used to be 30.07 percent in 1996, but in 2002 it dropped to 15.0 percent. This is in contrast to other mature economies, where domestic institutional ownership ranges from 30 to 50 percent.⁴⁸ Small fraction means that these institutions have not enough power to exert influence upon badly managed firms. Table 11 shows equity ownership figures by investor type in six countries. One interesting observation from Table 11 is that foreign investors, mostly composed of institutional investors, own a high fraction of shares in Korea. The equity ownership in listed companies is 36 percent as of December 2002. But, the figure is even higher in recent months. As of December 2003, foreign investors' ownership fraction was 40.5 percent. Foreign institutional investors, however, did not exercise much activism. This is probably because foreign investors knew that their activism would only trigger nationalistic sentiment among the Koreans, and they had to take such a side effect into account when making their decisions. This view, however, may have to change with the recent activism lead by Sovereign Asset Management against SK Corp. With its 14.99 percent equity stake in SK Corp., Sovereign Asset Management engaged itself into a proxy contest against the incumbent management to elect its own slate of directors and has also proposed to amend the Articles of

⁴⁷ See KSE (2003) for details

⁴⁸ The high equity ownership by category 'others' in Japan, Germany, France, and Korea indicate that in these countries either the government or the corporate sector have large equity ownerships. That is, SOEs dominating the economy or cross-shareholding prevalent as a corporate ownership structure.

Incorporation at the 2004 AGM.

Third, Korean *chaebols*, which take up most of the Korean corporations, are often entrenched and thus can easily win proxy contests initiated by outside shareholders. This definitely discourages institutional investors in Korea to engage in such activities. This, however, does not mean that outside shareholders stand no chance. People's Solidarity for Participatory Democracy (PSPD), an NGO that pioneered shareholder activism in Korea, has engaged in a number of proxy contests against *chaebol* management. Although PSPD never won enough vote to actually pass a proposal, it came close to it by targeting firms that are less entrenched, and soliciting proxies from foreign investors.⁴⁹ Sovereign Asset Management, which is targeting SK Corp., is taking the exact same strategy.

Fourth, Korean institutional investors never coordinates their proxy voting directions. Even if they hold only a small fraction of shares individually, if they unite together, they may be able to wield enough votes to win a proxy contest. But, this never happened in Korea. This is mostly because the Korean government dominated the Korea Investment Trust Companies Association (KITCA), the main trade association for Korean institutional investors. The Association Chairman was normally hand picked by the Ministry of Finance and Economy, and the Association was partly used as a vehicle to support government policies. Recently, however, we see some sign of change to make the Association truly independent from the government. This is partly due to the fact that more and more non-Korean asset management companies are entering the Korean market. They enter the market either by establishing a separate company under the Korean law or by establishing a joint-venture company with a Korean partner.

Fifth, with the exception of foreign investors, institutional investors in Korea suffer from conflict of interest problems. Institutional investors in Korea can be grouped into three categories: foreign institutional investors, domestic institutional investors under government control, and domestic institutional investors under *chaebol* control. Because of their ties to the government or the *chaebols*, the last two cannot exercise their shareholders' right independently solely for their clients.

For example, the Korea National Pension Fund (KNPF), which is *de facto* controlled by the Ministry of Health and Welfare, is suspected whether it would exercise its shareholders' right for the benefits of its pension beneficiaries or for the benefit of the Ministry.⁵⁰ Facing such criticism, the

⁴⁹ Some *chaebol* firms, however, accepted the proposal from PSPD before AGM, making it unnecessary for PSPD to take a formal action.

⁵⁰ The highest decision making body in regards to NPF's investment policy is the Korea National Pension Fund Management Committee (KNPFMC), which is composed of six ex-officio government officials and 15

Korean National Pension Fund Management Committee (KNPFMC) is discouraged from exercising its shareholders' right actively. At the time of this writing, it does not even have its own formal proxy policy.⁵¹ Because of the danger that government might intervene in KNPF's investment policy, it is also discouraged from investing in shares. Although the size of its fund is enormous (KRW 112 trillion), it invests only 3.4 percent in domestic shares.⁵² At the time of this writing, KNPFMC has not yet adopted any investment policy statement (IPS). One encouraging sign from KNPF, however, is that it has recently announced to give mandates to external investment managers to run corporate governance funds.⁵³

Most of the asset management companies in Korea have commercial ties to the *chaebols*. They are either directly owned by a *chaebol* affiliate, receive mandates from large *chaebol* insurance companies, or sell their products through large *chaebol* securities firms. Because of such commercial ties that they cannot ignore, many Korean asset management companies tend not to vote against the *chaebol* firms, even when it is against their clients' interest. It is also worth noting that there was a change in government policy in 2002. Before the revision of the *Monopoly Regulation & Fair Trade Act*, the *Securities Trust Act*, and the *Securities Investment Company Act*, in early 2002, *chaebol*-affiliated financial institutions were only allowed to do shadow-voting when voting on the shares issued by their industrial-affiliates.⁵⁴ With the revision of those Acts, the government allowed *chaebol*-affiliated financial institutions to engage in active voting up to 30 percent of shares issued by their industrial affiliates, despite the apparent conflict of interest problem.⁵⁵

D. Selected Policy Issues

non-government officials representing the pension beneficiaries. However, this committee is almost defunct. All the committee members are non-resident members, and almost no committee member has expertise in asset management. As such, the committee has not been showing any leadership.

⁵¹ This, however, does not mean that KNPF never vote. Actually, KNPF have been voting almost all their proxies, which is even more worrisome. Any exercise of shareholders' right should be based on the policies and guidelines set by the KNPFMC and implemented in a transparent manner.

⁵² As of December 2003, it amounts of KRW112 trillion. This is almost USD100 billion.

⁵³ This can be a good starting point. By giving out mandates to external investment managers to run corporate governance funds, KNPF would not only borrow outside expertise in institutional shareholder activism, but also easily justify its involvement in shareholder activism. This is because shareholder activism would be done not directly by KNPF, but indirectly via the corporate governance fund managers.

⁵⁴ Shadow-votes are counted to meet the quorum, but are not allowed to change the proportion between 'for' and 'against' votes.

⁵⁵ It is reported that such revision in law was made to protect listed firms from foreign takeover attempts.

A number of policy measures can be introduced so that Korean institutional investors can take a greater role in enhancing the governance of Korean corporations. But, we believe the most effective way is to make use of the Korean National Pension Fund.⁵⁶

The first step, however, is to revamp the governance structure of Korea National Pension Fund (KNPF) to earn credibility from the public. This is very important because without such trust from the Korean public, it would not be politically feasible for KNPF to aggressively take more equity exposure, let alone engage in shareholder activism. Currently, the Korea National Pension Fund Management Committee (KNPFMC) is composed of 21 members. The Minister of Health and Welfare chairs the Committee, and there are five other ex-officio Vice Minister-level government officials in the Committee. Although there are 15 non-government members sitting at the Committee, representing the beneficiaries, none of them are resident members, and none of them are required to have expertise in asset management. As such, KNPF does not have the three most important elements to be an effective investment committee: independence, leadership, and expertise.

To earn trust from the public, the *National Pension Act* should be revised so that a committee characterized by independence, leadership and expertise, can run KNPF. A number of changes can be made to accomplish this. First, the size of the KNPFMC Committee should be significantly reduced. The current size of 21 members is considered to be too large to expect a constructive discussion. The size, instead, should be around ten. Second, the Committee should have a number of resident members. At least, one-third should be full-time resident members.

Third, the President should appoint the resident Chair and other resident members of the Committee among a list of non-government candidates recommended by an independent nomination committee. The nomination committee should be composed of ex-officio government officials and representatives from the pension plan beneficiaries. Ex-officio government officials should not take up more than one third of the total number of nomination committee members. Also, the list of candidates should include only those that meet the expertise requirement pre-stipulated in the revised *National Pension Act*. Fourth, the President should also appoint other non-resident KNPFMC members, recommended by the representatives of pension plan beneficiaries. The Committee should include a limited number of ex-officio members from the government. May be two members when the size of the Committee is ten. Fifth, the revised *National Pension Act* should give KNPFMC a clear mandate to adopt a formal policy on corporate

⁵⁶ It should be emphasized, however, that the cost of shareholder activism should also be considered. Shareholder activism can be justified only when it gives net benefits to pension plan beneficiaries.

governance and detailed guidelines and procedures to implement shareholder activism. Such policies and guidelines should be disclosed. KNPF would be in a much better position to engage in shareholder activism once such governance reform is done.

Another important policy issue regarding the role of institutional investors is the conflict of interest problem faced by *chaebol*-affiliated firms.⁵⁷ As mentioned previously, *chebol* affiliated firms are allowed to vote on shares issued by their industrial-affiliates, despite the apparent conflict of interest problem. Those financial institutions are likely to vote ‘for’ the *chaebol* group chairman even when that is not in the best interest of their clients. Such practice would only reinforce the entrenchment problem, and thus worsen their governance structure.

To resolve this problem, it has been suggested to reserve the policy change made in 2002. That is, allowing only shadow-voting when those financial institutions want to vote on shares issued by their industrial-affiliates. Another policy alternative would be to allow their proxy voting, but under a certain set of conditions. The conditions would include the following. First, those financial institutions should disclose their conflict of interest situation, the problems that can arise, and the measures they took to resolve such problems. One way is to strictly follow the advice made by outside proxy service providers, which does not have any industrial ties⁵⁸. Second, those financial institutions should establish a proxy policy that has detailed guidelines and procedures on proxy voting. The highest decision making body, such as the board or the investment committee, should approve the proxy policy. Third, the proxy policy itself and the actual votes cast should be disclosed to the clients, and the supervisory authority, so that they can monitor the financial institution’s compliance to their proxy policies.

V. Concluding Remarks

In this paper, we review the developments that took place in the ‘Big Four’ after their full privatization. We show that POSCO, KT, and KT&G, which were privatized to have dispersed share ownership, have relatively high corporate governance standards. We also show that the ‘Big Four,’ have either maintained their superior performance or at least improved them. The remaining of the paper discusses on the two remaining concerns often raised regarding the newly privatized firms. That is, the issue of desired corporate ownership structure and the role of

⁵⁷ This, however, is not necessarily related to the governance of newly privatized firms.

⁵⁸ There exist a proxy service provider in Korea. The Center for Good Corporate Governance (CGCG), established in November 2001, provide voting recommendations on AGM resolution items for the largest 50 companies in the Korean market.

government.

As for the first issue, we try to provide a number of reasons why *chaebols* are not appropriate candidates to acquire newly privatized firms. One argument is that the ownership structure of Korean *chaebols* suffers from a number of incentive problems: other people's money agency problem, entrenchment agency problem, and tunneling. Related to this, we show that there is a considerable separation between the control and cash flow rights in *chaebol*-affiliated firms, and introduce empirical literature showing the link between separation and firm performance. We strongly believe that the *chaebol* ownership structure should not be candidate for large enterprises that can emerge by privatizing public enterprises, government-rescued banks, and bank-acquired firms during the crisis period. Instead, they are preferred to have a dispersed ownership structure with high corporate governance standards.

As for the second issue, we strongly argue that the most important role a government could play after privatization is to make sure that the newly privatized firms are management independent of government interference. But, we also emphasize that government should improve the institutional environment that would induce better governance from Korean corporations. In this respect, we stress the importance of enforcement, protection of minority shareholders' right, and the role of institutional investors. To make domestic institutional investors to take a more active role in improving the governance of Korean corporations, we argue that the first step would be to revamp the governance structure of Korean National Pension Fund.

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Table 1. Divestiture of Government Shares of Big Four

Names	Divested Shares	Divestiture Method
POSCO (Oct., 2000)	Government 3.1%	▪ 18.5%, DR (Dec. 98, Jul. 99, Sep. 00)
	KDB 23.6%	▪ 8.2%, stock repurchase (Dec. 99, Jun.00, Oct. 00)
Korea Heavy (Dec., 2000)	KDB 31.2%	▪ 24%, IPO (Sep. 00)
	KEPCO 40.5%	▪ 36%, tender offer to Doosan group (Dec. 00)
		▪ 11.7%, divestiture of KEPCO shares (Dec. 01)
KT&G (Oct., 2001)	Government 28.8%	▪ 18%, IPO (Oct. 99)
	KDB, IBK, KEXIM 52.8%	▪ 10%, EB (Dec. 00)
		▪ 19.8%, DR, EB (Oct. 01)
		▪ 19%, public offering, EB (Jun. 02)
		▪ 9.9%, DR (Oct. 02)
		▪ 4.6%, stock repurchase (Oct. 02)
KT (May, 2002)	Government 71.2%	▪ 32.3%, DR (May 99, Jun. 01)
		▪ 29.5%, public offering (Jan. 01, May 02)
		▪ 11.8%, EB, BW (Dec. 01)

Note: The month in the parenthesis in the first column indicates the month when government shares were fully divested.
Source: *White Paper on Public Sector Reform*, Ministry of Planning Budget

Table 2. Revenue Collected From Divesting the Big Four Shares

Names	Year	(Unit: billion KRW)		
		Government Revenue	Non-Government Revenue	Total
POSCO	1998	218.1	189.1	407.2
	1999	-	1,527.7	1,527.7
	2000	-	845.2	845.2
	Total	218.1	2,562.0	2,780.1
Korea Heavy	2000	-	154.3	154.3
	2001	-	394.6	394.6
	Total	-	548.9	548.9
KT&G	1999	798.2	159.3	957.5
	2000	-	414.8	414.8
	2001	461.1	200.7	661.8
	2002	-	1,017.2	1,017.2
	Total	1,259.3	1,792.0	3,051.3
KT	1999	1,339.1	1,562.3	2,901.4
	2001	3,095.6	-	3,095.6
	2002	6,702.9	-	6,702.9
	Total	11,137.6	1,562.3	12,699.9

Note: Non-government revenue refers to the revenue collected by government-owned corporations, such as KEPCO, KDB, IBK, or KEXIM

Source: *White Paper on Public Sector Reform*, Ministry of Planning and Budget

Table 3. Ownership Structure of Big Four

Names	Shareholders		Fraction of Shares (%)
POSCO (Dec. 2002)	Largest Shareholder	Brandes Investment Partners	3.97
	Other Major Shareholders	Pohang University	3.34
		SK group	3.34
		Nippon Steel	3.19
		Industrial Bank of Korea	2.34
		National Pension Fund	2.34
		Sub-Total	14.55
	Other Shareholders	Foreign	54.30
		Domestic	16.48
		ESOA	0.74
		Sub-Total	71.52
Treasury Stocks		9.96	
Total		100.00	
Doosan Heavy Industries & Construction (Dec. 2002)	Largest Shareholder	Doosan	38.20
	Other Major Shareholders	Korea Exchange Bank	15.74
		Korea Development Bank	12.60
		Sub-Total	28.34
	Other Shareholders	Foreign	1.00
		Domestic	15.57
		Sub-Total	16.57
	Treasury Stocks		17.89
Total		100.00	
KT&G (Dec. 2002)	Largest Shareholder and its Related Parties	Industrial Bank of Korea	10.75
		Related Parties	0.01
		Sub-Total	10.76
	Other Major Shareholder	Daehan Investment Trust	7.45
	Other Shareholders	Foreign	27.01
		Domestic	14.21
		ESOA	6.47
		Sub-Total	47.69
Treasury Stocks		34.10	
Total		100.00	
KT (June 2003)	Largest Shareholder	Brandes Investment Partners	6.39
	Other Major Shareholder	National Pension Corporation	2.70
	Other Shareholders	Foreign	38.00
		Domestic	20.79
		ESOA	6.62
		Sub-Total	65.41
	Treasury Stocks		25.49
Total		100.00	

Source: Korea Stock Exchange (KSE), Center for Good Corporate Governance (CGCG)

Table 4. Major Shareholders of POSCO

Shareholders	2002	2001
Brandes Investment Partners	3.97	4.72
Pohang University	3.70	3.59
Templeton Investment	3.43	4.27
SK group	3.34	3.19
Nippon Steel	3.19	3.09
Capital Research & Management	2.98	4.43
National Pension Corporation	2.34	1.90
Industrial Bank of Korea	2.34	3.12
Capital International	1.91	4.53
Bank of Ireland Asset Management	1.56	1.13
Putnam Investment Management	1.45	1.39
Samsung group	1.19	0.75
Mitsubishi Corp	1.17	1.13
Schroder Investment Management	1.09	1.24
Merrill Lynch	0.92	1.35
Prudential	0.51	1.19
Total	35.09	41.04

Source: POSCO (March 2003)

Table 5. Profitability of Big Four

	1996	1997	1998	1999	2000	2001	2002
POSCO	8.82	10.36	9.57	10.56	11.82	8.11	10.63
Industry	4.15	4.39	4.63	5.42	3.29	3.24	6.32
No. of Firms	21	21	21	21	21	20	18
	1996	1997	1998	1999	2000	2001	2002
Doosan H&C	-	-	-	-	2.32	3.02	4.85
Industry	7.30	6.04	1.44	3.24	5.55	5.41	9.32
No. of Firms	9	10	9	9	8	10	11
	1996	1997	1998	1999	2000	2001	2002
KT&G	-	-	-	7.06	11.13	12.24	13.46
	1996	1997	1998	1999	2000	2001	2002
KT	-	-	-	2.97	4.08	6.37	8.24
Industry	9.76	9.33	8.55	2.77	9.09	12.31	12.22
No. of Firms	2	2	2	2	2	2	2

Source: *TS2000* and annual reports

Table 6. Market Value of Big Four

	1996	1997	1998	1999	2000	2001	2002
POSCO	0.78	0.83	0.87	1.17	0.88	1.07	0.96
Industry	0.93	0.85	0.89	0.84	0.75	0.70	0.65
No. of Firms	21	21	21	22	21	21	19

	1996	1997	1998	1999	2000	2001	2002
Doosan H&C	-	-	-	-	0.64	0.84	0.66
Industry	1.44	0.95	1.06	1.09	0.74	0.87	0.90
No. of Firms	9	10	9	9	9	10	11

	1996	1997	1998	1999	2000	2001	2002
KT&G	-	-	-	1.51	1.22	1.30	1.25

	1996	1997	1998	1999	2000	2001	2002
KT	-	-	-	2.76	1.41	1.17	1.36
Industry	1.63	1.37	1.45	5.96	1.93	1.87	1.53
No. of Firms	2	2	2	2	2	2	2

Source: TS2000 and annual reports

Table 7. Share Return of Big Four

(Unit: percent)

POSCO	Before (Jan 3, '96 - Jul.2, '98)	During (Jul.3, '98 - Oct.4, '00)	After (Oct.5, '00 - Dec.26, '02)
Return	0.025	0.178	0.127
Return - KOSPI	0.146	0.029	0.095
Return - Industry	0.084	0.052	0.033

Doosan H&C	Before	During (Oct.24, '00 - Dec.12, '00)	After (Dec.13, '00 - Dec.26, '02)
Return	-	-0.768	0.183
Return - KOSPI	-	-0.803	0.132
Return - Industry	-	-0.601	0.088

KT&G	Before	During (Oct.8, '99 - Oct.31 '01)	After (Nov.1 '01 - Dec.26, '02)
Return	-	-0.073	0.015
Return - KOSPI	-	-0.016	-0.061

KT	Before	During (Dec.23, '98 - May 24, '02)	After (May 25, '02 - Dec.26, '02)
Return	-	0.144	-0.037
Return - KOSPI	-	0.061	0.151
Return - Industry	-	-0.006	0.071

Source: KSE and Korea Securities Research Institute (KSRI)

Table 8. Disparity Between Control and Cash Flow Rights

Rank	Group	Control Rights	Cash Flow Rights	Difference
1	Daewoo Motors	0.202	0.202	0.000
2	Daewoo Shipbuilding & Marine Engineering	0.003	0.003	0.000
3	Hankook Tire	0.383	0.359	0.025
4	HITE	0.435	0.403	0.031
5	Hyundai Development	0.233	0.200	0.034
6	KCC	0.511	0.473	0.038
7	Hyosung	0.310	0.266	0.044
8	Taihan Electronic Wire	0.758	0.695	0.063
9	Shinsaegae	0.435	0.316	0.119
10	Hyundai Heavy Industries	0.271	0.151	0.120
11	Tae Kwang	0.666	0.534	0.132
12	DC Chemical	0.504	0.371	0.133
13	Daelim	0.405	0.265	0.139
14	Dong Kuk Steel Mill	0.396	0.242	0.154
15	Daesang	0.491	0.333	0.158
16	Daesung	0.689	0.523	0.166
17	Nong Shim	0.534	0.354	0.180
18	CJ	0.408	0.225	0.184
19	Hanjin	0.358	0.172	0.185
20	Hyundai Department Store	0.519	0.323	0.196
21	Booyoung	0.516	0.314	0.202
22	Kolon	0.350	0.127	0.223
23	Dong Won	0.536	0.307	0.228
24	Samsung	0.297	0.068	0.228
25	Hyundai	0.293	0.061	0.231
26	Dongbu	0.520	0.282	0.238
27	Lotte	0.427	0.184	0.243
28	Kumho	0.523	0.273	0.251
29	LG	0.442	0.182	0.260
30	Trigem Computer	0.404	0.143	0.261
31	Hyundai Motors	0.319	0.048	0.271
32	SK	0.343	0.050	0.293
33	Young Poong	0.618	0.308	0.311
34	Hansol	0.412	0.096	0.316
35	Doosan	0.530	0.160	0.370
36	Tong Yang	0.598	0.204	0.394
37	Hanhwa	0.619	0.114	0.505
	Non-Weighted Average	0.439	0.252	0.188

Note: Figures for Lotte is not precise because we could not get access to the share ownership of Lotte's Japanese affiliates, and the share ownership of the controlling shareholder in those firms.

Source: KDI (2003). Raw data provided by the Korea Fair Trade Commission

Table 8. Disparity Between Control and Cash Flow Rights

Rank	Group	Control Rights	Cash Flow Rights	Difference
1	KARICO	0.004	0.004	0.000
2	Korea National Housing Corporation	0.002	0.002	0.000
3	KT	0.136	0.135	0.000
4	KOGAS	0.106	0.106	0.000
5	KT&G	0.128	0.128	0.000
6	KOWACO	0.001	0.001	0.000
7	KEPCO	0.365	0.365	0.000
8	Korea Land Corporation	0.027	0.027	0.000
9	Hanaro Telecom	0.050	0.049	0.001
10	Korea Highway Corporation	0.001	0.000	0.001
11	POSCO	0.169	0.131	0.038
12	MBC	0.901	0.314	0.587
	Non-Weighted Average	0.157	0.105	0.052

Source: KDI (2003). Raw data provided by the Korea Fair Trade Commission

Table 9. Big Six versus Family Firms

	Name	1996	1997	1998	1999	2000	
Net Income to Stockholder's Equity Ratio	KT & G	8.63	9.24	11.23	11.01	9.76	
	POSCO	9.49	-2.27	9.87	17.15	17.36	
	KOGAS	16.36	-48.76	13.03	10.14	4.04	
	KT	0.21	0.60	2.93	2.81	8.84	
	KEPCO	3.15	-3.62	6.29	4.84	5.63	
	Doosan H&C	15.21	-7.90	4.41	1.56	-1.49	
	Weighted Average of Listed Companies	2.96 (627)	-16.04 (630)	-8.69 (625)	-8.17 (570)	0.25 (628)	
	Weighted Average Excluding 'Big Six' Firms	1.99	-22.74	-15.25	-15.08	-3.41	
	Interest Coverage Ratio	KT & G	469.21	467.03	443.77	1729.72	912.41
		POSCO	2.75	0.97	3.13	8.07	7.60
KOGAS		3.09	-1.55	1.78	2.49	1.50	
KT		3.27	2.11	3.02	4.01	4.80	
KEPCO		2.02	-0.16	2.91	3.23	2.95	
Doosan H&C		4.91	0.67	2.18	1.27	0.50	
Weighted Average of Listed Companies		1.31 (627)	0.36 (630)	0.75 (625)	0.70 (570)	1.30 (628)	
Weighted Average Excluding 'Big Six' Firms		1.18	0.34	0.62	0.48	1.04	
Debt/Equity Ratio		KT & G	24.79	31.53	24.85	29.01	38.08
		POSCO	118.50	160.48	118.85	89.59	88.41
	KOGAS	230.23	555.79	273.70	184.22	259.02	
	KT	189.34	223.98	192.33	75.69	103.32	
	KEPCO	112.89	185.23	175.23	111.50	102.70	
	Doosan H&C	186.91	243.66	127.35	139.11	113.50	
	Weighted Average of Listed Companies	265.31 (627)	415.35 (630)	316.43 (625)	199.73 (570)	205.52 (628)	
	Weighted Average Excluding 'Big Six' Firms	326.41	532.08	382.75	246.20	253.14	

Source: Financial Supervisory Service

Table 10. Corporate Governance Rankings: The Top 10 List

Rank	2001	2002	2003
1	Housing & Commercial Bank	Hana Bank	KT
2	Hite	Samsung Fire & Marine Ins.	Good Morning Shinhan
3	KorAm Bank	Kookmin Bank	KT&G
4	Hana Bank	Shinhan Financial	Kookmin Bank
5	SK Telecom	S-Oil Corp	Koomin Credit Card
6	POSCO	KEPCO	Samsung Fire & Marine Ins.
7	Kookmin Bank	Kookmin Credit Card	LG Telcom
8	Shinsegae	KorAm Bank	Samsung Electronics
9	KT	Pacific Corp	Hana Bank
10	Samsung Electronics	KT&G	Chohung Bank

Source: CLSA (2001, 2002, and 2003)

Table 11. Equity Ownership By Investor Type

Rank	Domestic Institutions	Domestic Individuals	Foreigners	Others
U.K. (2000)	49.0	14.0	35.0	2.0
U.S. (2001)	46.7	40.2	11.2	1.9
Japan (2001)	40.1	19.7	18.3	21.8
Germany (2000)	37.0	7.0	14.0	32.0
France (2000)	31.0	7.0	30.0	32.0
Korea (2002)	15.9	22.3	36.0	25.8

Note: Others include government or other corporations

Source: KSE (2003)