

Responsible shareholding and long-term fiduciary duty: Emerging market case (Korea)

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Important characteristics of Korean companies (1)

- Practically all companies have a defined “controlling shareholder”
 - Large stake held by founder’s family
 - Inflated control block by indirect cross-shareholding
 - Most minority shareholders are short-term individual investors
 - Domestic institutional investors are not active
- Managed by Controlling shareholders
 - Professional managers under the influence of controlling shareholders
 - Board of Directors not independent from the management
 - A lot of Related party transactions (managed as a “Group”)

Important characteristics of Korean companies (2)

- Conflicts between classes of shareholders (controlling shareholder and minority shareholders)
 - Rather than conflicts between shareholders and management
 - Excessive control premium enjoyed solely by controlling shareholders
 - Take valuable business opportunities from the company(LGCI)
 - Subsidize privately owned company (SK Telecom)
 - Realize capital gain through insider trading (Kyunggi Chemical)
 - Use corporate money for illegal political donation (Samsung Electronics)
 - Inflate control block through unfair capital transaction
 - Squeeze out minority shareholders when stock price is undervalued
- Stock price severely under-priced (“Korean Discount”)

Source of Controlling Power

Top 10 Chaebols: Public and Private Companies

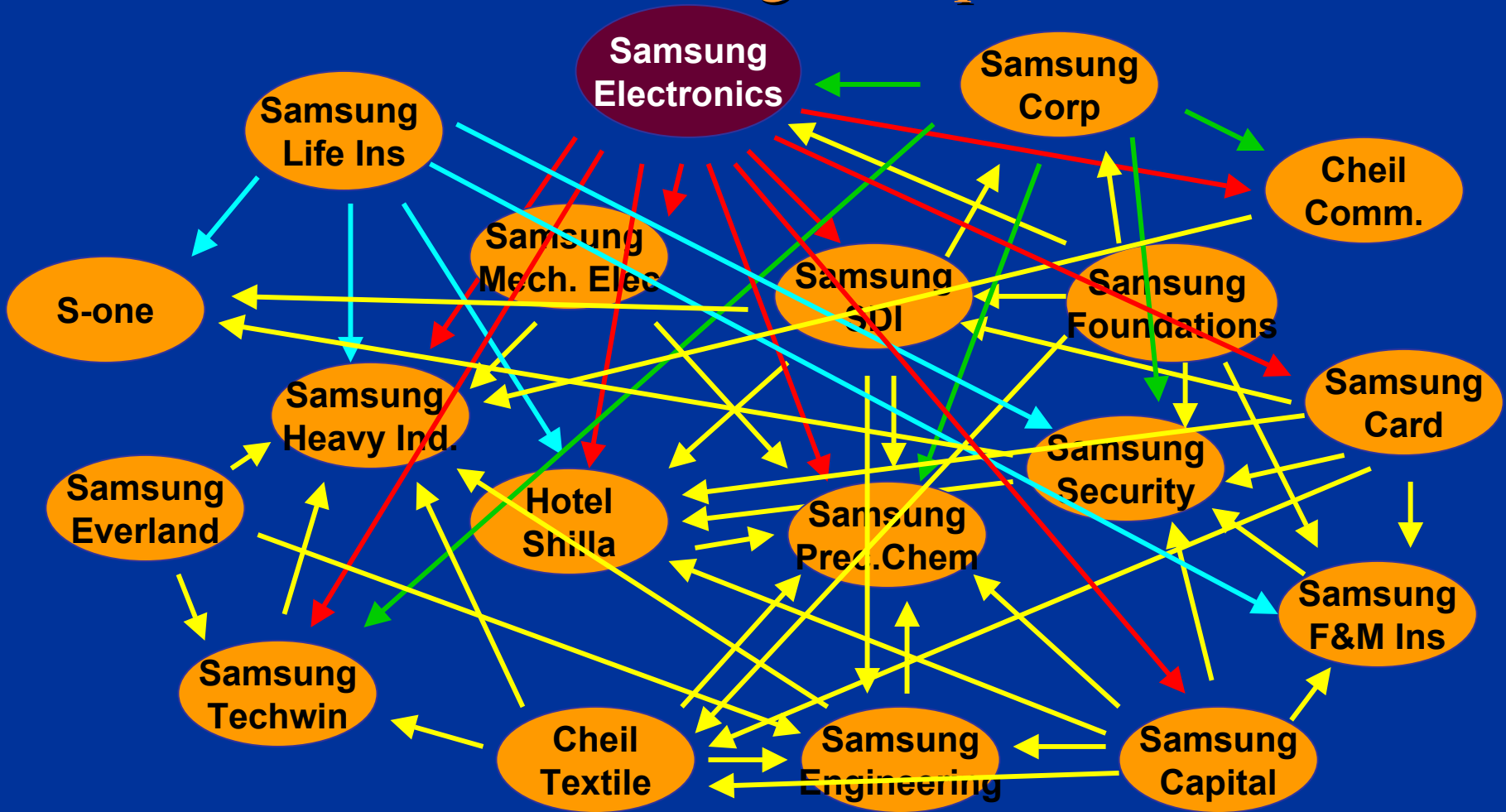
	Controlling Shareholder & Family	Affiliated Companies	Shares under Family Control
1997	9.54%	29.29%	39.57%
1998	7.82%	35.36%	44.16%
1999	5.76%	40.99%	48.07%
2000	4.30%	38.79%	44.72%
2001	4.29%	38.94%	47.61%

Ownership under Family Control: Non-Chaebol

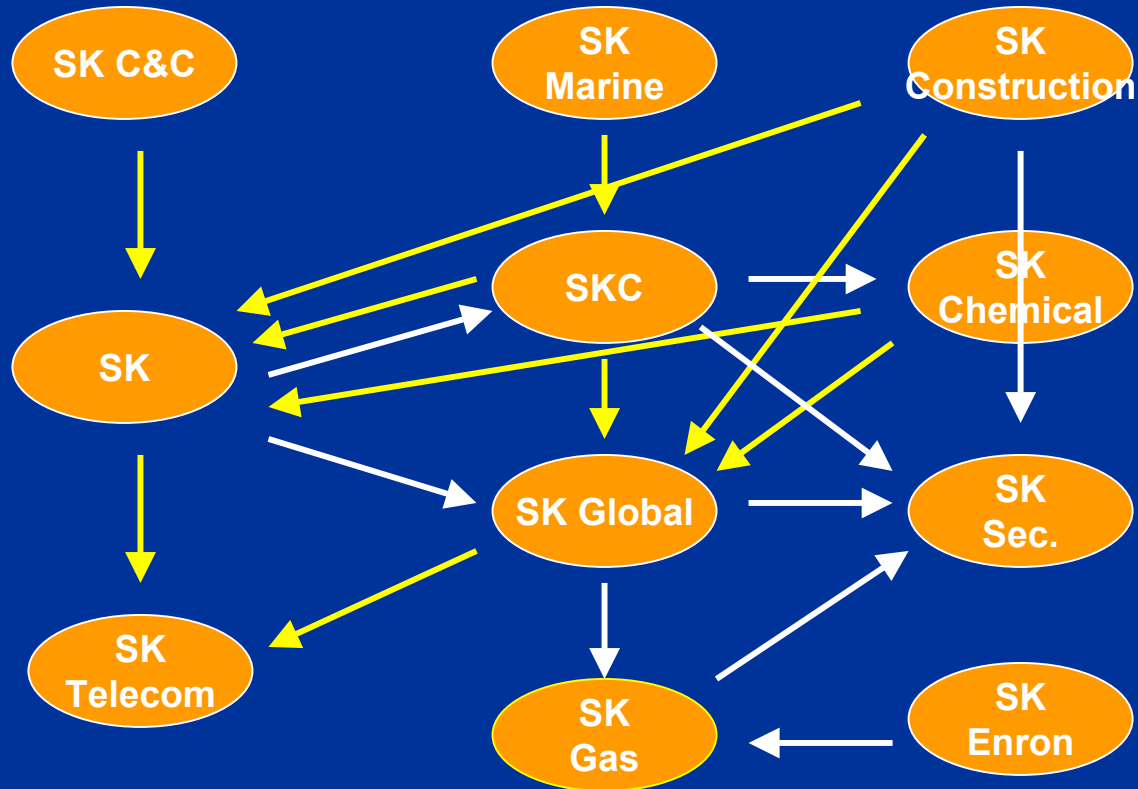
	Controlling Family and Management	Affiliated Companies	Shares under Family Control
1996	20.0%	4.7%	24.7%
1997	23.1%	7.0%	30.1%
1998	23.3%	7.2%	30.5%
1999	21.9%	8.2%	30.0%
2000	21.7%	8.8%	30.5%
2001	21.9%	8.3%	30.3%

Circular Equity Ownership

Samsung Group



Circular Equity Ownership SK Group



Insider Trading

by IMD, 2001

Korea 43rd



INSIDER TRADING

2001

Insider trading

is common in the stock market



is not common in the stock market

Ranking	Country	Score
1	DENMARK	8.197
2	FINLAND	7.850
3	SINGAPORE	7.612
4	AUSTRALIA	7.476
5	NETHERLANDS	7.250
6	LUXEMBOURG	7.222
7	CANADA	7.185
8	IRELAND	7.164
9	SWITZERLAND	6.977
10	GERMANY	6.961
11	USA	6.545
12	UNITED KINGDOM	6.530
13	ISRAEL	6.471
14	SWEDEN	6.424
15	NEW ZEALAND	6.415
16	HONG KONG	6.190
17	JAPAN	6.158
18	CHILE	6.145
19	BELGIUM	6.091
20	PORTUGAL	5.963
21	SPAIN	5.910
22	AUSTRIA	5.880
23	BRAZIL	5.852
24	FRANCE	5.822
25	ESTONIA	5.633
26	POLAND	5.609
27	SOUTH AFRICA	5.273
28	VENEZUELA	5.167
29	HUNGARY	5.152
30	ARGENTINA	5.054
31	SLOVENIA	4.986
32	ITALY	4.947
33	MEXICO	4.675
34	THAILAND	4.508
35	ICELAND	4.444
36	INDONESIA	4.400
37	NORWAY	4.370
38	SLOVAK REPUBLIC	4.308
39	MALAYSIA	4.253
40	INDIA	4.233
41	GREECE	4.200
42	COLOMBIA	4.195
43	KOREA	4.085
44	CZECH REPUBLIC	4.000
45	TURKEY	3.927
46	TAIWAN	3.899
47	RUSSIA	3.877
48	CHINA	3.495
49	PHILIPPINES	3.365

ABILITY TO SELF-FINANCE

2001

Companies

do not generate enough cash-flow to self-finance their investments



generate enough cash-flow to self-finance their investments

Ranking	Country	Score
1	FINLAND	7.500
2	NETHERLANDS	7.029
3	SWITZERLAND	6.932
4	SWEDEN	6.818
5	HONG KONG	6.667
6	IRELAND	6.607
7	SINGAPORE	6.567
8	USA	6.496
9	GERMANY	6.468
10	LUXEMBOURG	6.444
11	AUSTRALIA	6.405
12	AUSTRIA	6.400
13	CANADA	6.296
14	FRANCE	6.174
15	SPAIN	6.145
16	BELGIUM	6.000
17	DENMARK	5.943
18	UNITED KINGDOM	5.927
19	SOUTH AFRICA	5.870
20	CHILE	5.775
21	NEW ZEALAND	5.698
22	TAIWAN	5.610
23	HUNGARY	5.515
24	BRAZIL	5.429
25	ESTONIA	5.356
26	ISRAEL	5.176
27	ITALY	5.128
28	GREECE	5.073
29	NORWAY	4.967
30	MALAYSIA	4.937
31	MEXICO	4.935
32	ICELAND	4.889
32	PORTUGAL	4.889
34	INDIA	4.674
35	PHILIPPINES	4.603
36	JAPAN	4.569
37	VENEZUELA	4.385
38	INDONESIA	4.133
39	SLOVENIA	4.057
40	KOREA	3.972
41	TURKEY	3.821
42	COLOMBIA	3.750
43	POLAND	3.721
44	RUSSIA	3.605
45	THAILAND	3.563
46	ARGENTINA	3.333
47	CHINA	3.143
48	CZECH REPUBLIC	3.132
49	SLOVAK REPUBLIC	3.077

LEGAL REGULATION OF FINANCIAL INSTITUTIONS

2001

Legal regulation of financial institutions
 is inadequate for financial stability  is adequate for financial stability

Ranking	Country	Score
1	FINLAND	8.600
2	DENMARK	8.592
3	AUSTRALIA	8.548
4	NETHERLANDS	8.528
5	AUSTRIA	8.440
6	LUXEMBOURG	8.421
7	SWITZERLAND	8.276
8	SWEDEN	8.242
9	SINGAPORE	8.149
10	GERMANY	8.130
11	CHILE	8.056
12	CANADA	8.000
13	USA	7.864
14	HONG KONG	7.857
15	NEW ZEALAND	7.849
16	SOUTH AFRICA	7.766
17	BELGIUM	7.612
18	IRELAND	7.607
19	ESTONIA	7.467
20	ISRAEL	7.353
21	PORTUGAL	7.208
22	ICELAND	7.111
23	NORWAY	7.022
24	SPAIN	6.985
25	UNITED KINGDOM	6.929
26	FRANCE	6.774
27	MALAYSIA	6.506
28	ARGENTINA	6.500
29	GREECE	6.488
30	HUNGARY	6.438
31	INDIA	6.306
32	PHILIPPINES	6.267
33	BRAZIL	5.929
34	VENEZUELA	5.769
35	SLOVAK REPUBLIC	5.692
36	ITALY	5.513
37	COLOMBIA	5.317
38	POLAND	5.172
39	MEXICO	5.091
40	TAIWAN	4.987
41	THAILAND	4.985
42	CHINA	4.911
43	CZECH REPUBLIC	4.717
44	SLOVENIA	4.667
45	KOREA	4.451
46	INDONESIA	4.067
47	JAPAN	4.059
48	RUSSIA	4.000
49	TURKEY	3.857

RIGHTS AND RESPONSIBILITIES OF SHAREHOLDERS

2001

Rights and responsibilities of shareholders
 are not well-defined  are well-defined

Ranking	Country	Score
1	FINLAND	8.900
2	AUSTRALIA	8.612
3	SWEDEN	8.576
4	USA	8.521
5	DENMARK	8.394
6	CANADA	8.390
7	IRELAND	8.071
8	ISRAEL	8.059
9	ESTONIA	8.034
10	AUSTRIA	7.880
11	ICELAND	7.813
12	NETHERLANDS	16
13	UNITED KINGDOM	16
14	NORWAY	7.763
15	SOUTH AFRICA	7.714
16	LUXEMBOURG	7.684
17	SINGAPORE	7.642
18	GERMANY	7.636
19	SWITZERLAND	7.632
20	CHILE	7.521
21	HONG KONG	7.429
22	PORTUGAL	7.132
23	NEW ZEALAND	6.868
24	SPAIN	6.824
25	TURKEY	6.786
26	FRANCE	6.774
27	GREECE	6.732
28	TAIWAN	6.709
29	BRAZIL	6.643
30	VENEZUELA	6.640
31	BELGIUM	6.545
32	ARGENTINA	6.526
33	MEXICO	6.519
34	HUNGARY	6.485
35	COLOMBIA	6.450
36	PHILIPPINES	6.426
37	INDIA	6.391
38	POLAND	6.182
39	ITALY	6.128
40	MALAYSIA	5.924
41	SLOVAK REPUBLIC	5.846
42	CHINA	5.714
43	SLOVENIA	5.571
44	THAILAND	5.538
45	RUSSIA	5.481
46	INDONESIA	5.200
47	CZECH REPUBLIC	4.792
48	KOREA	4.282
49	JAPAN	4.194

Rights & Responsibilities of Shareholders by IMD, 2001

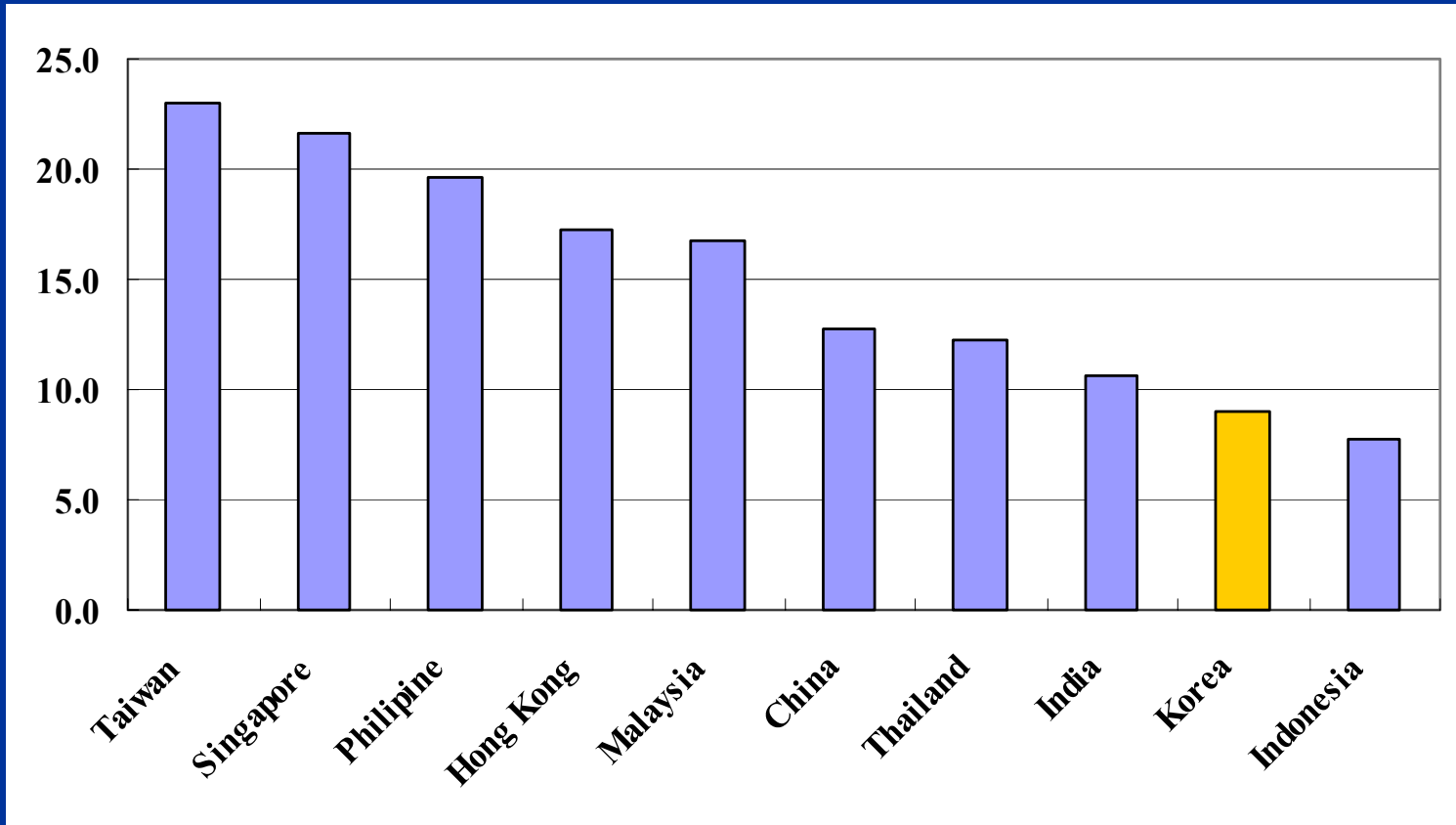
← Korea 48th

Rank of Efficacy of Board and Country Competitiveness : World Economic Forum

	Rank of Country Competitiveness	Rank of Efficacy of Board	Disparity
Singapore	10	17	-7
Japan	15	71	-56
Hong Kong	18	40	-22
Taiwan	21	22	-1
<i>Korea</i>	<i>28</i>	<i>61</i>	<i>-33</i>
India	36	54	-18
Malaysia	37	51	-14
Thailand	38	41	-3
China	47	67	-20
Philippines	54	43	11
Indonesia	55	63	-8

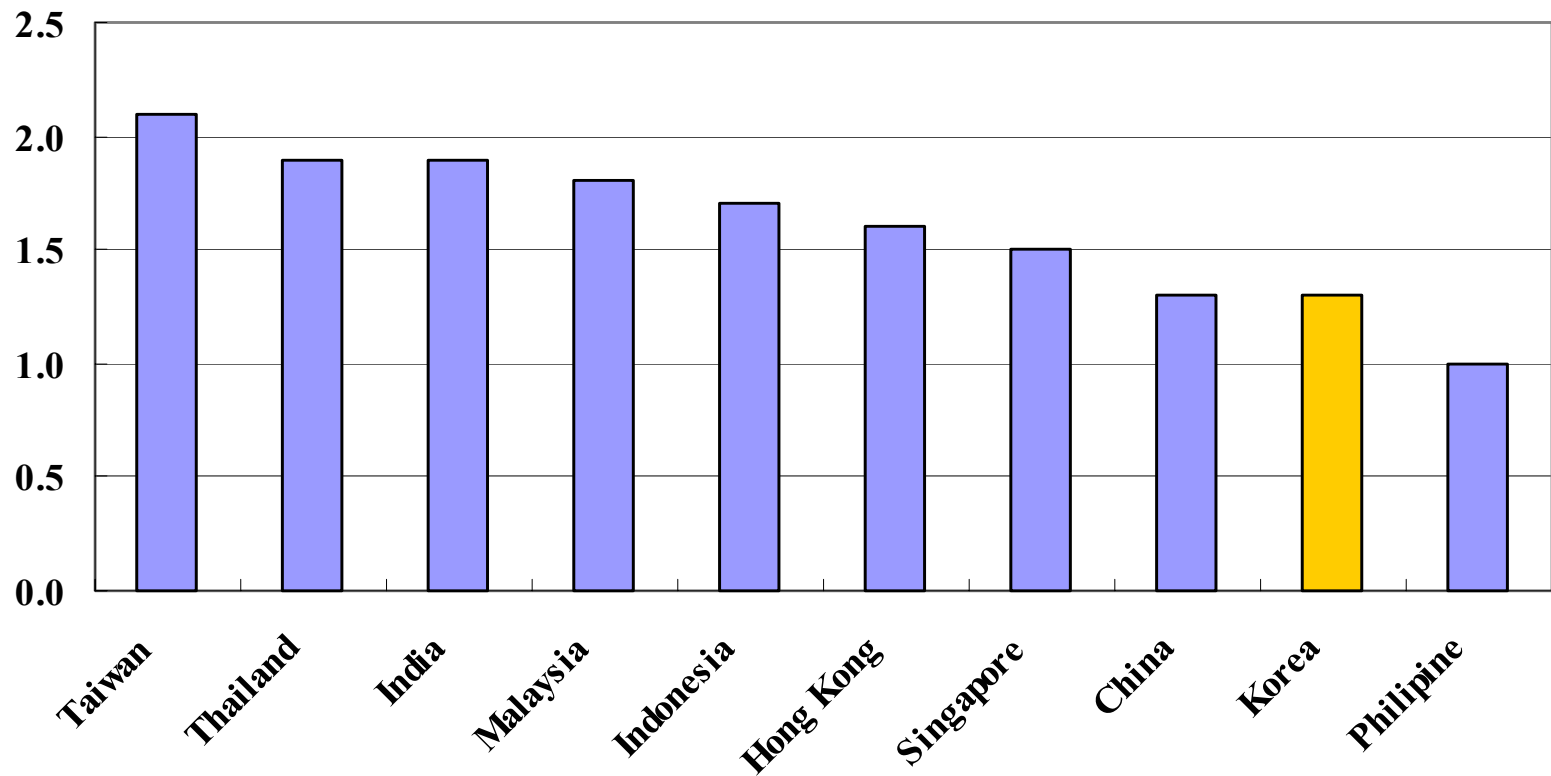
Price to Earning Ratio

Asian Emerging Markets, UBS May 2002



Price to Book Ratio

Asian Emerging Markets, UBS May 2002



Semiconductors: Valuation

September 20, 2002 UBS Warbrug

	Market Cap	PER	EV/Sales	EV/EBITDA
	\$m	02E	02E	02E
Samsung Electronics	41,298	7.5	1.1	3.9
TSMC	24,572	18.6	5.1	9.0
Rohm	14,536	25.6	4.4	9.9
UMC	11,194	20.0	4.7	9.0
Toshiba	10,240	30.1	0.2	5.6
Micron	7,647	-18.6		34.9
Infenion	4,395	-7.7		15.4

Problems from the standpoint of Social Responsibility

- Exploitation of Minority Shareholders (reverse wealth distribution)
- Chaebol as a unique social entity
 - Have presence in every aspect of economic activities of society (manufacture, construction, medical, media, banking, insurance, education, etc.)
 - Monopolizes resources: Eliminate diversity
 - Builds monopoly power and entry barrier: threats to small and medium business
 - Exerts great influence on politicians and government (corruption)
 - Avoids environmental liabilities
 - Ignores employees' rights
- Greater Risk to National Economy
 - When Chaebol failed... (Daewoo, Hanbo, Hyundai...) -> 1997 IMF crisis

PSPD's Shareholder Activism from early 1997

- Started as a part of Chaebol Reform Movement
 - All other trials for Chaebol reforms failed
 - Utilize status as one of owners of Chaebol companies
 - Targeted top Chaebol companies (such as Samsung, SK and Hyundai)
 - Utilize an effective venue of GSMs (media exposure)
 - Resorted to minority shareholders' rights in corporation law (derivative lawsuit, inspection of books, shareholder proposal, proxy contest)
- Make Big companies accountable to the shareholders & the society as a whole

Two Notable Cases

- Korea First Bank Case
 - Chairman of a listed commercial bank extended heavy loan to a financially troubled Chaebol company (Bribery from the controlling shareholder and pressure from the government)
 - Bankruptcy of the company -> Bankruptcy of the bank- > Huge public fund poured into the bank
 - PSPD won \$33.3 million judgment in a derivative lawsuit
- Samsung Electronics Case
 - Subsidize failing affiliate company, Illegal political donation at the expense of the company, subsidize affiliated newspaper company...
 - PSPD won \$81.4 million judgment in a derivative lawsuit

Positive Changes in Corporate Governance

- Increased awareness on minority shareholders' rights and corporate governance
- Disclosures are more reliable
- Related party transactions decreased
- Profitability rather than Size
- New Regulations
 - Outside directors requirement
 - Limitation on indirect cross-shareholding
 - Regulation on related party transaction
 - Minority shareholders' rights strengthened

Persistent Problems in Corporate Governance

- Old habits are hardly changing
 - Mindset of controlling family is the same
 - Persistent moral hazard
- Enforcement of regulation is not effective
- Independence of outside director in question
- Management control descended to 3rd Generation
- Entrenched ownership structure
 - Control via ownership by affiliated companies
 - Minority shareholders not institutionalized

New Phase of Shareholder Activism

- Center for Good Corporate Governance
 - CGInfo Service (www.cginfo.co.kr)
 - Analyze corporate governance structure of top 49 companies
 - Daily monitor corporate governance behaviors of top 49 companies
 - Distribute reports to foreign and domestic institutional investors
 - Proxy consulting service
 - CG Funds
 - IFC CG Fund : private equity approach
 - Midas Fund: public investment approach
 - Joint Meeting with SRI movement groups