

〈論 文〉

# Transformational Strategic Behavior of Korean Company under the IMF Surveillance

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## 1. Introduction

The crisis of the South Korean economy which begun from the shocking financial currency crisis in November, 1997 has passed about two years, spreading lots of confusion and anguish to all over the South Korean society. It is very difficult to arrange shrewdly the crisis situation of the South Korean economy in the meantime that shook violently, and to prospect the direction of the development of crisis in the future. However, if we arrange in the viewpoint that the economic crisis made what environment to a corporate or people who work and affected what them, and read by using some parts of statistics, we can recognize 3 stages of development process of economic crisis. For example, the statistics are foreign currency reserves, exchange fluctuation, unemployment rate, nominal wage change trend, and the company bankruptcy number of cases, etc.

The 1st stage is the term from November 21, 1997 when the so-called IMF surveillance started in quest of an urgent capital request to IMF, to May, 1998 foreign currency reserves and exchange fluctuation settled in a stillness aspect of affairs once. It is the term that it was doubtful of survival of a company in a precarious state with dullness of the business of a degree very much. The debt ratio of company's financial structure got worse further (debt ratios of big business: 298%/1996 — 413%/1997) and financial currency was the worst, and the ordinary working funds of a company were drained. Mass communications of those days have reported that the number of companies taken

out dishonor every month had surpassed 3000, and the rate of note dishonor had been imminent to 2%.

The 2nd stage is the term from June, 1998 to October, 1998. The worst situation (fall in Default) has passed, and governmental corporate structural adjustment scheme has taken completely in action. Although domestic demand depression, the depression of export, and dullness of business still continued, it was backed up for a little decline of interest rate, and decreases of the financial cost of a company, and that recovery feeling of cash mobility began to be visible. Although The rate of bankruptcy and the unemployment rate of this term reach the highest value, it changes to reduction hence -forth. It enters into the regular round-table conference between the government and the major five zaibatsu chief, and a governmental corporate structural-adjustment program starts to work completely in July of the same year. The big deal program which is going to strengthen the international competitive power of the five major Zaibatsu have reached agreement fundamentally between Zaibatsu. Big deal program means making a major domain of business strengthen through business exchange.

The 3rd stage is the term until it results now from November, 1998. Foreign currency reserves have changed stable and the management environment of a company improved very much. However, it is the term when the demand to corporate reform increased. It is backed up for a cut down of international interest rate, a strong yen, and low oil price etc., vigor returned to business activity, and the stock price, the nominal wage are recovered to the situation before a currency crisis. Although the unemployment rate is stabilized on the level of 7%, domestic demand is expanded and it is beginning to show even the overheating feeling of business.

However, it is the situation that most critics have not loosened the prudent or pessimistic view about whether the present recovery mood is connected to the new jump by continuing as it is. The reason is that it turns out well that it is not the matter by which reform of an economic system is finished simply so. Rather, the conflict between the economic subjective involved in a structural adjustment deepened more. Furthermore, the social demand about corporate reform have advanced to even the

dissolution of the zaibatsu, and the subject that reforms the way that should be of corporate behavior and an economic system. It can be said that the crisis of the South Korean economy system started from external currency crisis is processing which has experienced internal credit crisis.

Recently, the new perspective which critics the situation of South Korean economy has appeared. Until now, the causes and structure of an economic crisis were studied, and the point of argument how to evaluate governmental prescription and the reaction of corporate occupied the mainstream. Recently, the argument has spread to more essential concern, such as problem of corporate control structure of the big business, the opacity of management, the way that should be of an economic system and new corporate governance system.

In this paper, the problem of South Korean economy system and zaibatsu is examined, and the composition of an economic crisis is grasped collectively.

Secondly, It is argued whether what it can affect strategic behavior of Korean companies by examining the contents of the structural adjustment programs performed now from scheme of big deal and work out.

## **2. Understanding of South Korean society and Zaibatsu**

The function and the role of the zaibatsu in South Korean society did not cease at the simple economical problem, but have made the critical axis of a social structural change. The central and dominant influence of the zaibatsu in connection with change of South Korean society is formed through a zaibatsu growth process. It can be said that the characteristic of the zaibatsu grasped from the economical importance of zaibatsu and structure of a zaibatsu problem is peculiar to South Korean society.

### **1)The Korean style economic system and Zaibatsu: Zaibatsu, what are problems?**

The Korean economy system is explained in many cases in the characteristic relations

Transformational Strategic Behavior of Korean Company under the IMF Surveillance of government-company. The characteristic relation of the government-company in the Korean economy system has been explained through the so-called theory of developmental state paradigm such as *governed market*, *state capitalism*, *the Korean Inc.*, and *developmental state*. Therefore, South Korean economy's having lapsed into the crisis and having become under the IMF control is exactly that failure of zaibatsu management advanced into the crisis of the national economy.

### **Linguistics of Zaibatsu**

The definition of zaibatsu with scientific terminology has not necessarily become settled.

Generally, it is understood in many cases in a meaning called the large scale company group generated in late-developing industrialized countries, such as Japan and Korea. As the concept that points out especially peculiar Korean big-business corporate system, it is common noun-ized with the notation to say "Chaebol " or "Jaebol " in the English area.

Although, big business, and company group may be used in the same implications for convenience, with a zaibatsu, it needs to distinguish the big business from the peculiar character of zaibatsu at least.

A zaibatsu is not the individual big business simply, but big-business group, or a company group. Of course, a zaibatsu and a company group may be distinguished. Within a zaibatsu, possession and management is combined, moreover a major stockholder commands two or more multiple company groups, and holds absolute management power.

On the other hand, an company group means building a management union through capital and human joint form, while two or more company groups use the original right of management, while possession and management are separated and managerial rule is accomplished.

Although a zaibatsu and a company group can understand as one form of the combination between companies, in the zaibatsu, the character of the longitudinal

combination is characteristic, and the character of lateral combination is characteristic in company group.

Unlike the Korea, the meaning of the zaibatsu in Japan is considered to be a thing with the strong implications as a company group.

**Zaibatsu growth process**

In the Korea, it is consistent after the World War II that the company was founded and forsterd and grown as part of industrial policy, through the distribution policy of the resources by the government,

The South Korean zaibatsu was formed by the 1950s and have accomplished rapid growth, reorganization, and development in the economical development policy which advanced by the government in powerful after that at the time of the economic aid by the United States after World War II.

《Table 1》 is collected roughly the growth process of the South Korean zaibatsu over for about 50 years.

《Table 1》 The growth process of South Korean Zaibatsu

	Up to 1950s	1960-1970s	1980s and later
Growth domains	Light industries	Export Light industries Heavy and chemical industries	All industries Capital export
Growth sources	Exchange gain	Low wage labor force	Export expansion Stimulation of domestic demant (Monopolistic rule of small and medium-sized company of a consumer)
Growth stages	Merchant capital-character	Industrial capital	Monopolistic cspital

Zaibatsu's ups and downs are also intensive in the such process of formation and growth. Six zaibatus have dropped out in the 60s, and four zaibatus have dropped out in the ten major zaibatus in the 70s, respectively.

Zaibatsu rank is mostly stabilized after the 80s focusing on a higher rank zaibatsu. However, while South Korean economy goes into IMF surveillance and has passed two years, only 17 company among the 30 big businesses has survived (as of December, 99).

### **Characteristics of Zaibatsu**

Firstly, the essence of the control structure of the South Korean zaibatsu is the point that ownership and the management prerogatives are completely unified by the zaibatsu chief and the specific family. A specific family's constituent becomes the control stockholder of one zaibatsu in set, and some of the constituent holds owner-control. Secondly, a zaibatsu chief and family constituent all do not own the companies in a zaibatsu. Only some main companies (mainly listed company) will be owned, all subsidiary companies will be owned as a result through the process in which these companies own remaining listed company/unlisted company in cooperation with other subsidiary companies, and the right of management will be acquired.

The 3rd, the relation of the family constituent who participates in possession is wide range, and becomes some dozens of persons in many cases. Also in it, some of constituents hold the big share. Moreover, the family constituent who participates in management is restricted to the top management who holds the big share, its man brother, and the 2nd man in many cases. Furthermore, position and rank called the chief who is holding substantial zaibatsu ownership is only a common-name in a zaibatsu, and takes no responsibility legally natural. Moreover, feudal system from which a chief's status is inherited by the 2nd generation is maintained.

Considering the essential feature, the zaibatsu is governed by the specific power, management and possession are not separated. The characteristics of " Dictatorial management control" are strong. It is called " Dynasty-autocracy management control system".

## **2) Economical specific gravity of Zaibatsu and control structure**

The 30 major zaibatus have occupied 51.8% of all industrial sales as of 1996. Moreover, the rate of the ten major zaibatus is 43%, and the rate of the four major zaibatus is 31.2%.

If the phase of the zaibatsu occupied in a manufacturing-industry section is seen, the zaibatsu will hold 36.6% of added value, 52.5% of gross assets, and 13.8% of all workers.

Moreover, in the number of employees, although the four major zaibatus are low levels at 8.4%, gross assets occupy at 29.2%, and added value occupy at 22%, relatively the status is overwhelming.

If it sees from a market share, the rate at which a market share goes less than into the 3rd place in the products of the 30 major zaibatus has reached to no less than 64.5%. The 1st place is 33.2%. The rate in which the products of the five major zaibatus go less than into the 3rd place occupies 71.7%, and the 1st place is still 37.45%.

The share of the 30 major zaibatus in financial industry is 45.05%, and, as for the five major zaibatus is 19.60%, the ten major is 28.08%, the 20 major is 37.67% respectively.

The 30 major zaibatus are provided with 21.5% of the total loaned money of a financial institution, and 38.4% of the loaned money in the 2nd financial area is again concentrated on the 30 major zaibatus.

## **3. Reconstruction of economic system and structural adjustment of Zaibatsu**

### **1) The dimension of a structural-adjustment problem**

Severe conditions were given under the IMF surveillance, and South Korean economy has resulted even in the situation that management of the autonomous national economy is restrained.

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There are the views that the surveillance of IMF is the severe restrictions to national management, however, on the other hand, the perspectives that it is the best chance which cannot overlook for reform and reorganization of an economic system at large has also appeared.

《Table 2》 Summary of the IMF Conditionalities

The main support conditions	Contents	The result brought
Fiscal/Monetary Policy	<ul style="list-style-type: none"> <li>·Deceleration of real GDP/Curtailed Budget</li> <li>·High interest rate</li> <li>·Raising of a tax</li> </ul>	<ul style="list-style-type: none"> <li>·High unemployment rate</li> <li>·Inflationary Pressure</li> </ul>
Measure against a zaibatsu	<p>Internal-affairs-reform of Zaibatsu</p> <ul style="list-style-type: none"> <li>·Provision of consolidated financial statements</li> <li>Application of an international accounting standards</li> <li>·Independent external audits, A director's fullness duty reinforcement, Introduction of an external director system</li> <li>·Reinforcement of a right of minor stockholders</li> </ul> <p>External-affairs-reform of Zaibatsu</p> <ul style="list-style-type: none"> <li>·Reinforcement of Authority of the Faire Trade Commission</li> <li>·Prohibition of bank establishment by Zaibatsu</li> </ul> <p>Dissolution of Overinvestment</p> <ul style="list-style-type: none"> <li>·Liberalization of foreign capital inversment and M&amp;A</li> <li>·Dissolution of mutual loan guarantess among conglomerates' affiliates.</li> <li>·Maintenance of a bankruptcy related law</li> <li>·Improvement of financial structure (including BIS capital standard)</li> </ul>	<ul style="list-style-type: none"> <li>·The contents which force it zaibatsu integrate and conglomerate, basically</li> <li>·Zaibatsu restructuring, slimming (Convenient for foreign csptial)</li> </ul>
Trade and capital account liberalization	<ul style="list-style-type: none"> <li>·Expansion of foreign capital investment (It pulls up from 26% to 55%, during the 98 fiscal year)</li> <li>·To facilitate labor market flexibility</li> <li>·Preparation for establishment condition of holding company</li> </ul>	<ul style="list-style-type: none"> <li>·Promotion of Investment /M&amp;A by foreign csptial</li> </ul>

Source: IMF Korea: Request for Stand-By Arrangement, December 3, 1997.

The requests from IMF are realized with three pillars containing of fiscal and monetary policy, the measure against a zaibatsu, and trade and capital account liberalization. (see the 《Table 2》 )

Fiscal and monetary policy is built around a strong macroeconomic framework designed to continue the ordinary adjustment in the external current account, build up international reserves, and contain inflationary pressures, involving a tighter monetary stance and significant fiscal adjustment. The policy of the measure against a zaibatsu is built to reduce the high degree of reliance of corporations and financial institution on short-term debt and allow a better diversification of risk in economy. The goal is promoting a zaibatsu, internal and external reform and overinvestment dissolution. Trade and capital account liberalization policy aims at promoting the investment by foreign capital.

South Korean government have demanded urgent capital request to IMF on November 21, 1997, IMF attaches in response to it on December 3. "IMF Korea: Request for Stand-By Arrangement". It is said that the strictly confidential document (Strictly Confidential) to say was shown to the South Korean government.

Instantly, the 1st letter of intent and the memorandum (Memorandum on the Economic Program) were exchanged on the next day (December 4).

Henceforth, the concrete contents and mediation matter of a support package were exchanged one after another in the form of the 2nd letter of intent(December 24), the 3rd letter of intent(January 9, 1998), the 4th letter of intent(February 17), and the 5th letter of intent(May 15), respectively.

Meeting it, the South Korean government have set up the five-item principle and subject for corporate governance and corporate structure.

The main contents are as follows.

- i ) Transparency reservation of Corporate Management
- ii ) Dissolution and of mutual loan guarantees among conglomerates' affiliates.
- iii) Improvement of financial structure (debt ratio to equity capital is reduced to 200 % or less, and it unites with BIS standard)

iv) Setup of domain and main-force enterprise by the zaibatsu, furthermore cooperation reinforcement with small and medium-sized enterprises.

v) Reinforcement of managerial and ruling stockholders' responsibility.

Moreover, concrete action program was set up. Exit which drives out unsound corporate from market, big deal, and work out are them. Here, the contents will be examined focusing on big deal and work out.

## 2) Big Deal

Big deal means large-scale business transactions and business exchange performed for the five major zaibatus. It is distinguished from Work Out performed by targeting 6 big-business group to 64 big-business group.

Big deal is performed through the process of narrowing and setting up of core domain. The five major zaibatus specialize to business domain that has competitive power most, respectively.

Big deal programs in eight fields of industry, such as a semiconductor, airplane, petro-chemistry, railroad vehicles, power-generation equipments, engine for vessels, oil refinement, and Automobile/Electronics, is planned as of December, 1998(see Table 3).The main techniques are performed with three form, such as Integrated corporation establishment (fields: airplane, petro-chemistry and railroad vehicles), merger, change of jurisdiction, and undertaking(fields: semiconductor, power-generation equipments, engine for vessels, and oil refinement), and exchange(fields: Automobile/Electronics). The economical meaning of Big Deal is in the points which is going to dissolve the excess and duplicate investment of the zaibatsu in large-scale business. Conventionally, The South Korean zaibatsu has advanced the thoughtless management expansion. It is exactly the zaibatsu egoism, which was naturally made to produce the inefficient problem of duplication and overinvestment, and made national economy the hostage. It is the situation that may cause joint collapse of the industrial world in an economic crisis.

Big deal is the program that created the hottest concern and friction in the governmental structural adjustment policy. It is an urgent concern whether big deal scheme will be successful from now on with respect to the overall structural adjustment of South Korean economy.

《Table 3》 The object and the promotion conditions of Big Deal Program

Business Domain	Big Deal conditions
Semiconductor	<ul style="list-style-type: none"> <li>· Semiconductor business of LG is transferred to <i>Hyundai</i> (52.5%), Samsung (47.5%)</li> <li>· Negotiation of employment succession is processing</li> </ul>
Airplane	<ul style="list-style-type: none"> <li>· <i>Integrated corporation</i> establishment participating Hyundai, Samsung, and Daewoo</li> <li>· (Korean Airlines)</li> <li>· 1/3 or more excess capacity is canceled</li> </ul>
Petro-chemistry	<ul style="list-style-type: none"> <li>· <i>Integrated corporation</i> establishment participating Hyundai and Samsung</li> <li>· Debt of 1,500 billion (Won) is postponed to foreign-funding attraction decision (50% or more).</li> </ul>
Railroads vehicles	<ul style="list-style-type: none"> <li>· <i>Integrated corporation</i> establishment participating Hyundai, Daewoo, and Hanjin</li> <li>· The debt of 70 billion-75 billion (Won) to investment conversion</li> </ul>
Power-generation equipment	<ul style="list-style-type: none"> <li>· Power-generation equipment business of Hyundai and Samsung is transferred to <i>Korean Heavy Industry</i></li> </ul>
Engine for vessels	<ul style="list-style-type: none"> <li>· Engine for vessels business of Samsung is transferred to <i>Korean Heavy Industry</i> (40%), Hyundai (60%)</li> </ul>
Oil refinement	<ul style="list-style-type: none"> <li>· Hyundai oil refinement is <i>undertaking</i> Hanhwa oil refinement business</li> </ul>
Automobile/ Electronics	<ul style="list-style-type: none"> <li>· Business exchange between <i>Samsung</i> and <i>Daewoo</i> (Automobile to Daewoo, Electronics to Samsung)</li> </ul>

Source: Korea Financial Supervisory Commission, *The major five groups structural-adjustment promotion situation* " December 14, 1998.

### 3) Work Out

Work out is performed for the 6-64 big-business group except the five major zaibatsus, according to the original structural-adjustment plan.

Work out is a concept that points out a series of process of company improvement aiming at attaining normalization of the financial structure and management of a corporate.

Work out is a cosmetics term that aims at a slim figure through physical training, originally. It is said that J. Welch (CEO of the GE) has promoted the structural-adjustment plan for GE by the name of work out the end of the 80s. When selected to the work out company, various support will be provided from a related bank (main bank) .

First of all, the restriction on the managerial affairs with the prescription of related bank will be received. However, a part of loaned money is converted into an investment, postponement and mitigation of the Interest payment about a loaned money, and an additional loan are also provided.

At the beginning, big deal program was applied to the five major zaibatsus and work out program was still applied to a 6-64 big-business group. The background had recognition that capital burden capability was scarce at the company group of 6 or less size, while the five major zaibatsus had capital burden capability.

Unlike early stages [ of a structural adjustment ], from around the ends of the year 1998, the companies which make the selection application for work out spontaneously increase in number, and the disposal which objectifies a basis of selection is also taken. Recently, the company that desires work out selection has come even among the five major zaibatsus. In the case of the Daewoo, the cash currency crisis was caused in mid-August, 1999, 12 companies will become a work out object in keiretsu affiliated companies of 25 of Daewoo which caused the so-called Daewoo situation, and the route to regeneration will begin to be followed.

#### 4. Replace with the Conclusion: The new horizons of corporate behavior

Above, the contents of a structural-adjustment program of the South Korean zaibatsu under the IMF surveillance were examined focusing on big deal and work out scheme. The South Korean government can be evaluated as that which was consistent and has advanced the structural-adjustment program in order to overcome an economic crisis. However, some points in question can also be pointed out about the rationality of a policy, or the problem on execution process.

First, we are anxious about the limit of the non-market-reform policy. There is unreasonableness in understanding a big deal program as autonomous business exchange between companies.

It is carried out in order to secure the transparency of corporate management and to raise market competitive power that the non-market-regulation system which forces zaibatsu reintegrating, fundamentally. This is a serious irony.

Second, There is a problem of the rationality of a structural-adjustment standard. The government aimed at the epoch-making improvement of corporate financial structure, and came carrying out the debt ratio of a corporate to 200% or less as a preferential judgment index of a structural adjustment.

First of all, a debt ratio can have the various meaning that change with possession structure or situations of a financial market. 200% on a uniform number is so much meaningless. Actually, there is nothing then through a financial-affairs structure improvement, and the case of the company which makes the most of the facilities method that is going to lower a debt ratio through simple property reassessment is also reported.

Third, big deal and work out program have the risk that allows a moral hazard easily depending the implementing method. About overinvestment or faithless management, the responsibility of the mistaken decision-making must be asked. In a present adjustment system, there is a possibility that the self-responsibility of an economic unit

may be offset in transactions or a processing process.

Fourth, big deal program has the anxiety that makes monopoly and the oligopoly phenomenon of a company newly enhance. Although enhancement of monopoly and the oligopoly phenomenon of the industry by the specific zaibatsu may bring the merit of economies of scale, it can weaken market competitive power.

A structural adjustment is exactly making an economic adjustment system shift to the further new adjustment system. It can be said that it has started whether the success or failure of a structural adjustment may function with sufficient balance in the adjustment system with the new behavioral pattern of each economic unit. From the position in which each economic unit differs, three final targets are checked as a result of a company structural adjustment.

Governmental final policy target is establishment of responsible professional management system. Business side expects as a result of a structural adjustment that the economic system by which autonomous company activity is guaranteed. On the other hand, labor side desires establishment of an employee stockholder system.

It is expected that such three visions or demands of each economic unit will spread as a new environmental factor of strategic corporate behavior from now on. How company pumps up such a demand, and whether it is reflected in strategic behavior attracts our attention.

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