Global Standards vs. Local Specificity in Corporate Restructuring: Lessons from the Korea*

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Abstract: This paper has investigated institutional changes in corporate sector in Korea. The following three areas of institutional reform have been covered by the case studies of the relevant firms: 1) workforce restructuring in labor-management relations, 2) independent directors in corporate governance, and 3) business restructuring. It first confirms the importance of 'transparency' in corporate management and institutions as one of the most fundamental requirements of the market economy and second, the importance of how to handle some tension between the global standards and local specificity in corporate reform. The paper has argued that emphasis on flexibility as a global standard in labor markets tend to result in segmented labor markets when it faces with local specificity of strong labor unions. Emphasis on market-based corporate

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restructuring as global standard in restructuring might not work well, given the local specificity of opaque corporate governance which accord high premium for the controlling management. Also, introduction of independent directors as a global standard in the board might have limited impacts when there is strong and long-term owners in place to keep personal control over the firms (local specificity).

Ⅰ. Introduction

This year marks the 10 year anniversary of the financial crisis that had swept Asia. While the Korean economy is now stabilized with modest growth rates, however, the process of post-crisis reform and recovery has not been smooth. The Korean economy made a remarkable recovery in 1999, growing at the rate of almost 10% after a minus 6% in the crisis year of 1998. It went through, however, a gradual slow-down again since then. Changes in the stock prices, which reflect closely the course of economic change in Korea, was as low as something close to 200 at the peak of the crisis, soared up to 1,000 in 1999, and then decreased again to the pre-crisis level of 600 in 2000. Since then, stock prices has continued to increase, finally surpassing the level of 1,000 and even reaching the level of 1,400 in 2006 and 2007. While such high stock prices might reflect much sound corporate profitability after restructuring and subsequence changes, it is also important to ask what has been the possible lessons from the stories of corporate restructuring and changes.

While opaque corporate governance and the associated "Korea discount" in the stock prices used to be the hall mark of the Korean corporate sector, the turning around in the Korean stock market is often associated with the realization that the Korean corporate sector has significantly improved in terms of transparency although difference views and perceptions also exist. Given this diverse perception of corporate sector in Korea, it is

timely to look at what has actually happened in the corporate sector in Korea and how it has changed the corporate behavior. In diverse areas of reform, we see the heavy influence of global standards, such as flexibility and transparency. Looking back at the pre-crisis economic conditions in Korea, one finds that the both rigidity and information gap due to lack of transparency was the cause of the 1997 financial crisis. Thus, while it is quite natural to see the post-crisis reform to center around the issue of flexibility and transparency, we have also seen interestingly the process of implanting such global values not smooth or sometimes ineffective. In this regard, one important issue we have identified is some tension between the global practices and the pre-existing local conditions of Korea and this could be an issue in any countries that try to implement corporate restructuring influenced by global standard.

There are many cases that standard reform package or procedure dose not work, due to specific, institutional features of the Korean economy. For example, in labor relations, strong resistance from the labor against lay-off had to do with the segmented nature of the labor market and the related lack of well-developed external labor market. Korean labor market in large firms is the primary market. Thus, once you are kicked out of this market, you find your new wages substantially reduced from the first job. Thus workers in big firm resist strongly against lay-off. This feature of labor market institution tends to lower labor market flexibility. In business restructuring, one source of difficulty is the owner-controlled nature of the Korean firms. Thus, owner has high stake in the firm, and tend to resist inter-firm restructuring (M&A; sales) of firm.

Although there has already appeared some volume of researches on the crisis and post-crisis reform in Asia including Korea (K. Lee, et al. 2005; Haggard, Lim, and Kim, 2003; Haley and Richter 2002; Hooley and Yoo 2002; K. Lee 2002; Chung

2002), few studies exist looking at the phenomenon from the tension between the global standards vs. local specificity by detailed case studies. Thus, while the details of the corporate reforms should be quite diverse and multi-dimensional, we will focus on the issues of how to implement the globally accepted business practices in a country, like Korea, and, at the same time, how institutional specificity of the Korean economy interfere with the process of implanting the global standard. In other words, this paper will analyze institutional changes in the Korean economy with a focus on the tension between the global standard and local specificity.

We will address this issue by looking at the several areas of institutional reform: 1) labor-management relations, 2) corporate governance, and 3) business restructuring. These are key institutions, which was the critical elements in post-crisis reform in Korea. Methodologically, we will conduct case studies of the firms, which will allow an in-depth analysis of changes in corporate institutions. In labor-management relations we will examine the cases of Hyundai Motors. For corporate governance reform we will look at four companies which are active in promoting the role of the board of directors, such as the POSCO, Kookmin Bank, Hyundai Heavy Industries and SK Telecom. In business restructuring, several firms in the paper production industry will be subject to study. We expect the study to reveal how the reform has changed the transparency aspect of the corporate sector, what the remaining problems are, and what future reforms are needed in Korea.

Following three sections of two, three, and four, address each of the three aspects of corporate change, respectively, namely the labor-management relations, corporate governance reform, and business restructuring. After that, concluding remarks follow.

Ⅱ. Workforce Restructuring: the Case of an Automobile Company

Backgrounds

As Lee and Lee (1992) stressed, labor market in Korea during the high growth period used to be flexible, with the management commanding full authority over workforce restructuring. Employment also used to short-term oriented. However, after the turning point toward labor shortages and especially since the 1980s, employment practices gradually became longer. With the democratization with the new government under the President Roh, and after experiencing mass-scale labor strike in 1987, the power of labor unions became stronger and labor market turned into a very rigid one. However, this change was OK at least when the economy continued to grow as the businesses were always in need of more workforce.

Since the mid 1990s the economy started to slow down and fell into the crisis in 1997. With this turn of events, labor market flexibility, especially downsizing of workforce, emerged as one of the most issues in overall corporate restructuring. Actually it was early 1997 even before the onset of the crisis that first revision of the labor-related laws was made driven by the strong demand from the management side. However, it was right after the onset of the crisis, namely February 1998 that the revised law officially allowed the management the right to discharge the "redundant" workforce when the companies are in bad situations.

To examine the process of workforce restructuring, this paper takes the case of an automobile company which experienced, first time as a big company, a large scale downsizing of workforce after the revised labor law came into practice. This was a very noteworthy case that attracted national and international atten-

tion given its size and meanings.

The Story of Hyundai Motors[1].

The company felt the need for workforce restructuring and initiated it since mid 1997 with the slowdown of domestic market. With the crisis in the late 1997 and plummeting of domestic demand, the company formally announced the downsizing plan in April 1998. The plan estimated about 40.6% (18,730 employees) of its workforce as redundant workforce as the firm was experiencing a 40% cut of production volume from the normal level of 1,540,000 units to 910,000 units annually. Actually the average operation of this company was only 44.3% during the first six months of 1998. Out of this estimated 18,730, the firm said it would keep about 8,000 skilled workers, but had to discharge the remaining 10, 166.

The company first started to invite three rounds of voluntary quit-off from April to June with a total of 4,455 workers filing for retirement. The initial response from the labor was that no single worker can be laid-off and work sharing combined with reduction of work hours should be introduced. As the bargaining between the management and labor did not not reach agreement, the firm came up with the list of 2,678 workers to be discharged in July 20, and soon issued the actual order of discharge to 1,538 workers on July 31.

The labor unions responded with 6 rounds of strikes, occupation of work floor and sit-ins since July 20, 1998. This led to a complete stop of the factory for 34 days, as well as physical conflicts among the blue and while colored workers with a total of 173 white-colored middle-level managers injured and a total of 282 labor leaders sued by the company.

As the negotiation between the business and labor sides was

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1. This part relies on Cho (2002)

not producing any conclusions, the government decided to intervene in recognition of importance of this case, especially for international investors. With the intermediary role of the government involving the office of the president and minister of labor themselves, the both sides reached, on August 24, an agreement with lay-off of 277 workers and 2,018 workers given on-leave without pay as its core contents. This agreement of lay-off, though the numbers are small, was an important compromise from the labor side, in light of its initial position against any lay-off, and, on the other hand, reflection of the management's strong will, given the symbolic meaning of involuntary lay-off, the first case of its kind in Korea.

The whole process up to this point can be summarized as in table 1 below. In sum, the company can be said to achieve its goal, although not solely by lay-off means, close to its original target of 10,166, if one include those separated in the form of retirement and on-leave without pay. The short run cost of this process from the management side amounted to roughly 1 billion US dollar worth cars of 100,000 unit to be produced during the period of strikes, as well as minimum living subsidies to those on-leave without pay and one time complementary pay for those discharged and retired. Taking into these costs, net benefit of the whole plan of workforce downsizing is quite problematic. Moreover, as the company made a remarkable turn-around in 1999 even to the level of acquiring another major automobile companies, the company recalled those who were on-leave without pay and those who were discharged.

Table 1. Final Outcome of Workforce Restructuring in an Automobile Company A
(unit: persons)

Number of workers	Redundent workers estimated	To be kept(8,564)		Separated (10,166)			
		With Wage cut	With replacing sub-contracting employees	By restructuring plan (8,764)			Natural reduction, etc.
				On-leave without pay	Voluntary re-tirement	Dis-charged	
46,132	18,730	6,842	1,722	2,018	6,451	277	1,420

• Source: Ministry of Labor, the Government of Korea; Recited from Cho (2002).
• Notes: As of the August 24 agreement between the management and labor.

Discussion

In the long term perspective, additional loss from the management side should include the disappearance among workers of former feeling of life-time attachment to the company as they, for the first time, witness the large-scale lay-off of fellow workers. In the meantime, workers realized the importance of labor unions as a representative body to protect their interests. What the management gained should include some discipline effect as the everyday performance evaluation file was used as the main evidence data in screening worker for lay-off candidates.

Also, if one knew such quick turn-around in advance, one doubts whether it really had to go through all the hassles that hurt both sides of the management and labor, in terms of not only monetary costs but also symbolic value of job security and loyalty.

This makes one wonder why the both sides did not avoid the path toward mutual destruction or huge costs. As one of the most important reason for both sides not to reach agreement, we would like to point out the lack of transparency in the firm management and accounting matters. It is often observed that the management does not provide the labor side with sufficient in-

formation about the status of the company and tend to avoid huge profit from appearing in accounting books with a view to ward off the distribution demand from the labor side, and at the same time, to avoid losses, too, since they don't want to be blamed (H. Cho 1999). As a matter of fact, the labor side argued that the accounting book showed a profit of 700 million Won but in reality the company (A automobile) made losses in 1997. It is widely broadcasted that the post-bankruptcy investigation of the accounting books of two other major automobile companies revealed unbelievable degree of manipulation of the magnitude of several billion US dollars.

Given this situation and practices, it is hard to blame the labor side not believing what is told by the management about the situation of the company. Since the accounting books are manipulated, it is meaningless to provide the labor side with the accounting information of the company and to demand such information. Thus, the labor unions had not choice but simply demand more from the other side, regardless of the situation of the company (S. Cho 2000). Even when the company fall into troubles, the labor side perceive it as a fault of the management side, but feels that they are not responsible for it. So, in turn they feel furious when they have to be laid-off out of situation they are not responsible for (Bae 2001).

At a more fundamental level, the issue of management transparency goes beyond the level of the labor-management conflict to the level of the top level governance. Only when a good corporate governance system is in place, one can expect transparent management and information disclosure to the labor side. Only after than, a more efficient and less costly bargaining between the labor and management can prevail.

While the above discussion endorse the importance of transparency as a global value, the turbulent course of restructuring also revealed the importance of local specificity. As a matter of

fact, the labor relation is one of the areas where institutional factors are crucial. In our case, too, strong resistance from the labor side has to do with the segmented nature of Korean labor market. Labor market in Korea is one of the most segmented labor markets in the world with substantial difference between the primary and secondary market. In the primary market, including workers in the big businesses, mostly so-called Chaebols, average wage rates are higher and working conditions and fringe benefits were much better than in the secondary market (M. Cho 1993). While in unitary labor market, workers' pay does not vary much across jobs, that is not the case in Korea. If you are discharged from the primary market, your new wage rates in the secondary markets is reduced substantially. You are not only losing wage but also all the networks and social relations built in the primary market over the years. As Korea is still a society where personnel relations are very critical in the business life, the value of those intangible things are much higher than in the West.

The segmented nature of labor market in Korea is an important impediment for any effort to increase numerical flexibility in Korea. Workers resist strongly against labor restructuring since their monetary losses are substantial. Worker's side also complained about the unemployment insurance and benefits system which they perceived not providing sufficient safety nets.

Ⅲ. Introducing the Independent Directors for better Corporate Governance

Backgrounds

The main role of board is to make sure that the management of the firm act in the best interest of shareholders. The board advises CEO in the formulation of strategic decisions and may replace CEO when the firm shows poor performance. When the con-

trolling shareholder acts as a CEO of the firm, the board has to keep the controlling shareholder from making decisions that conflict with the interest of minority shareholders. The role of board can be understood as a separation of decision management and decision control (Fama & Jensen 1983). While CEO focuses on the role of decision management such as suggestion and execution of tasks, the board assumes the role of decision control such as monitoring and compensation of the management and prevents business failures.

Although Korean commercial codes stipulate that roles of CEO and board should be separated, boards of most Korean firms have long failed to play roles required by laws. Boards failed to play the role of monitoring management since the boards consisted mostly of inside directors who are de facto selected by the controlling shareholder. Controlling shareholders of most Korean firms have long acted as CEO without being monitored by boards.

Failure of boards to play the role of monitoring management has long been one of causes for mistake and opaqueness of business in Korea. Most Korean firms have suffered from overinvestment and unrelated diversification since boards have failed to monitor the management. Especially over-investment of Korean firms including chaebols is now thought to be a main factor that brought about economic crisis of 1997. Many Korean firms went into financial distress and eventually went bankrupt due to the hang over from over-investment and excessive leverage. Many financial institutions including a couple of nationwide banks also went into financial distress. If the controlling shareholder try to maximize his own utility by accepting projects of which net present value are negative, the firm can suffer from over-investment and excessive unrelated diversification. The controlling shareholder has incentive to accept a negative NPV project if he believe that personal utility from controlling new business increases by accepting the project (Bebchuk, L., Reinier, K., and George

Triantis, 2000). If the board plays the role of monitoring management properly, discretionary behavior of controlling shareholder can be checked in advance.

In Korea, however, the tendency of the controlling shareholder to make decisions based on his own utility maximization has not been restrained since the controlling shareholder has de facto controlled the board for a long time. Opaqueness of business resulting from the failure of the board has been mostly found in internal transaction among affiliated firms of chaebols. The management of affiliated firms that are not properly monitored by the board can participate in internal transactions that increase personal benefits of the controlling shareholder at the cost of minority shareholders. As for financial transaction affiliated firms of a chaebol that have sufficient cash flows provide financing to poorly performing affiliated firms through debt guarantee, participation in right offerings and purchase of bonds. With regards to internal goods market an affiliated firm of a chaebol can subsidize other firms in the same chaebol by either purchasing expensively or selling cheaply. Although such internal transactions can create a conflict of interest between the controlling shareholder and minority shareholders they have long been recognized as a custom in business transactions in chaebols. Mistakes in strategic decision making and opaqueness of business caused by the failure of board can be singled out as one of factors that prevent Korean firms from creating value. That stock prices of Korean companies with profitability and growth potential are often undervalued relative to those of other countries might reflect concerns that Korean firms are unlikely to practice value based management due to the failure of board.

It follows that it was expected to reestablish the role of boards of Korean firm in order to induce Korean firms to practice value based management and strengthen competitiveness. Another reason for the importance of reestablishing the role of

boards in Korea is that there are no alternative corporate governance mechanism that substitutes and make up for the board. During the post-crisis reform, the Korean government tried to improve the role of the board by mandating outside director system.

However, whether outside director system has now been successfully established in Korea is still an open question. Some surveys showed that mandate of outside directors in boards has not yet changed the behavior of boards of Korean listed firms in a prominent way. Major findings from the surveys are as follows.

First, most outside directors of Korean listed firms are appointed on recommendation by controlling shareholder or CEO. According to the survey on listed firms by Korea Stock Exchange in 2001, 76% of listed firms appointed outside directors on recommendation by the controlling shareholder while only 5.9% appointed outside directors on recommendation by the financial institution from which they borrowed money.. Second, outside directors are found not to have expertise. According to Lee et al (2001) only 10% of respondents say that outside directors are equipped with expertise.

Discussions so far show that despite the urgency of restoring the role of boards through mandate of outside director anglo-american style board which is comprised mostly of outside director are not yet successfully implemented in Korea. Considering that outside director system has advanced with a lot of trials and errors in the U.S since it was introduced 30 years ago, it will take some time for boards to change fully through outside directors in Korea. Only three years have passed since outside directors were mandated in Korea. More important reason for the ineffectiveness of outside director system in Korea is the local specificity that is not compatible with outside director system that is de facto imported from America. Existing institutions related to outside director system might be fundamentally different from those of America.

The purpose of this study is to look at the implementation of outside director system in Korea through case studies. Together with effects of outside director system on the behavior of the firms we focus on local specificity that is thought to prevent successful implementation of outside director system. Four Korean listed firms are selected for case studies. All four firms are known to be relatively successful in implementing outside director system. Case studies on these four firms are expected to provide implications for policies related to outside director system. Before this, let us provide some survey of the literature on the role of the board and firm performance

Linking the Board to Firm Behavior: the literature

Results of empirical studies on board composition and firm performance suggest that there exists no consistent relation between the proportion of outside directors and firm performance. Baysinger and Butler (1985) find that the proportion of outside directors correlates with return on equity. Rosenstein and Wyatt (1990) examine the stock price reaction on the day of the announcement that outside directors will be added to the board and find that there is a statistically significant increase in stock prices. Meanwhile, Hermalin and Weisbach (1991) report that there is no significant relation between the proportion of outside directors and tobin q. Yermack (1996) finds a significant negative correlation between proportion of outside directors and tobin q.

While empirical studies fail to show conclusive evidences on the effect of board composition on firm performance, a lot of studies do provide evidences that outside director dominated boards act in the interest of shareholders when the firm is in trouble. Weisbach (1998) finds that outside director dominated boards are more likely than other boards to fire a poorly performing CEO. Brickley et al (1994) report that the stock market reaction to poison pills is positive when the board is dominated by outside di-

rectors and negative when is not.

Byrd and Hickman(1992) report that tender offer bidders with outside directors dominated boards do not earn any gain in stock price while bidders without such boards suffer losses of 1.8% in stock price. They also find that bidders with outside directors dominated boards offer lower tender offer premia. This result implies that outside directors can keep CEO from building an empire. Despite the perspective that outside directors are ineffective in enhancing the independence of the board since there are dominated by the management, outside directors do seem to make a difference under certain conditions.

The lack of evidences relating the proportion of outside directors in the board to firm performance can be explained by the endogeneity of the proportion of outside directors in the board. The proportion of outside directors might be endogenously determined by the characteristics of the firm. The endogeneity of outside directors suggests that outside directors are not always needed. For example, slowly growing firms in a mature industry may need a high proportion of outside directors to control the incentive of managers to over invest. In relation to this argument Agrawal and Knoeber (1996) find the correlation between a high proportion of outside directors in the board and lower Tobin's q. The fact that the proportion of outside directors is determined by the ownership structure also suggests the endogeneity of outside directors. It appears that firms with concentrated ownership in which a large shareholder act as a CEO tend to have an inside director dominated board. Meanwhile firms with dispersed ownership in which a professional manager act as a CEO tend to have an outside director dominated board. The composition of the board can also be affected by the bargaining power of CEO against the board. Hermalin and Weisbach (1998) shows that the independence of the board is determined by CEO's bargaining power over the board selection process which comes from his per-

ceived ability relative to potential successors.

Regarding qualification of outside directors, it is said hat they should be provided incentives and equipped with ability to represent the interests of shareholders in order to play their role effectively. Reputation and equity ownership are found to affect the incentive of outside shareholders to monitor management.[2] The length of outside directors' tenure on the board, outside directors' professional qualifications and the size of the board affect the ability of outside director to monitor management.

Case studies[3]

The Case of SK telecom

Outside director system was introduced to SK telecom in 1997. The board of SK Telecom is now regarded as one of a few boards that successfully incorporate outside director system. In this company, outside directors are observed to participate actively in board activities. During the period from 1998 to 199 outside directors held their meetings 80 times. The main impetus for active participation of outside directors is a desire to maintain reputation as good monitors of the management as they all are quite well recognized persons in the Korean society and business community. Outside directors were under pressure to play their roles effectively. Activity of outside directors were carefully monitored by NGO, foreign investors and newspapers at that time since SK Telecom was a key member firm of SK group, one of the

2. See Gilson(1990), Cotter et al(1997) and Perry(1999)
3. Case studies depend mostly on interviews. In each case we had interview with either an executive officer or senior manager of each firm whose job is to handle tasks related to board. All interviews were done in January of 2002. Major questions in interviews include background and effects of introduction of outside director system. Information in this part relies on Jinn (2002)

five biggest chaebols in Korea. The fact that outside directors were not compensated by stock based compensations, when they were first time invited to the board, suggests that reputation alone worked as an incentive for outside directors.

The main impact of the introduction of outside director system was observed to be enhanced transparency of internal transaction among affiliated firms in the group. As transactions got more transparent, unnecessary conflicts either among affiliated firms or divisions of the same firm that had been common before the introduction of outside director system, disappeared. For example, purchasing department of SK Telecom used to buy equipments, which were more expensive and did not meet specifications of ordering department, from either an affiliated firm or a certain supplier. As a result purchasing department were in conflicts with ordering department. Since the outside director system was introduced unfair transactions like this disappeared and purchasing department restored good relation with ordering department.

Despite decent success in terms of enhancing transparency through outside director system the board of SK telecom still needs to be improved in that directors of SK telecom lack independency and expertise as a professional. As is the case in most chaebol firms in Korea it is very difficult to appoint outside directors independent from the management since the controlling shareholder of chaebols has controls over all affiliated firms and influence the appointment process of outside directors. This is also true of SK telecom. SK telecom also found difficulty locating competent outside directors, especially outside directors with career as a professional manager. This is because professional managers have not been produced in Korea due to the chaebol regime where professional managers could not play their roles properly.

The Case of Posco (formerly Pohang Steel Co.)

Outside director system was introduced to Posco in 1997. More than half of board members were appointed as outside directors and a non-Korean outside director was appointed. Board of Posco has been reformed not only to incorporate government policies for enhancing transparency and efficiency of business but also to enhance competitiveness of Posco after privatization by adopting global standards in the management practices.

The fact that Posco has had a lot of free cash flow for years can be one strong reason for it to have a solid outsider director system. If Posco, which is run by a professional manager and has a dispersed ownership structure, continue to be in a situation like this, it is vulnerable to agency problems associated with free cash flow. It is well known that managers of firm with dispersed ownership and weak governance tend to pursue unrelated diversification and accept negative NPV projects. Outside director dominated board of Posco can prevent CEO from making decisions based on this incentive.

One of the effects of the introduction of outside director system on the management practice of Posco is found to be the fact that discretionary decision making by CEO is no longer possible. Before the outside director system was introduced, the board of Posco used to play only the passive role of formally approving decisions made by CEO. However, the management of CEO should now follow procedures of persuading board members to approve their decision. Also as the specific duties of board, committees and CEO were clearly defined, transparency of business is greatly enhanced. After outside director system was introduced. it got difficult for CEO of Posco to make discretionary expenditures which used to be possible before. For example, donations of more than 100 million won committed by CEO has been rejected four or five times by outside directors since CEO could not justify his donation decisions to the board members. The practice of de facto

unanimous decision making in the board is also one of factors that enhanced business transparency of Posco. If some of outside directors object to decisions made by the management, the management follows the process of revising decisions until outside directors no longer find any foundation for their objection.

Although the board of Posco is rated as one of the best in Korea, it is thought not to have many competent outside directors. Posco has had difficulty locating qualified outside directors, especially outside directors with a career as a professional manager. Posco had to appoint a foreign outside director to make up for the overall quality of the board and made a great success. A senior manager of Posco says that foreign outside director made a great contribution to enhancing overall quality of the board.

The Case of Kookmin Bank

The main impetus for the introduction of outside director system to the Kookmin Bank was to make the bank more competitive by adopting global standards in business practice. Kookmin Bank introduced outside director system since the reform of board was regarded as one of most important and urgent things to do to improve corporate governance. Outside director system has been successfully working. One of reasons for the success is that the CEO during this time, Mr. Jeong Tai Kim, of the bank understood the merit of outside director system and strongly supported it.

Since the introduction of outside director system, neither a remarkable improvement of performance nor a dramatic change of business practice has been found. However, the main impact of outside director system on the bank was that the process of decision-making got more transparent. Before the introduction of outside director system the role of board was not clearly defined and the roles of the management and the board was not separated.

As the specific duties of board, special committees and CEO were clearly defined after the introduction of outside director system, the board could contribute to enhancing the quality of decision making by spending a lot of time discussing important issues. Another impact of outside director system is that outside director system made it difficult for the government to intervene in the business of the bank. For example, the board of Kookmin bank rejected the pressure of the government to purchase bonds sold by Daewoo when Daewoo was in liquidity crisis.

Although Kookmin bank successfully introduced outside director system, it also has had difficulty locating competent outside directors. Especially, Kookmin bank had to appoint more outside directors than other firms since it has outside director dominated board. Without a well- developed market for outside directors it is very difficult for Koobmin bank to locate 12 outside directors. As is the case in Posco, KooKmin bank had to appoint foreign outside directors to enhance the quality of the board.

The Case of Hyundai Heavy Industries (HHI)

HHI appointed half of directors as outside directors at 2000 general shareholders meeting even if it was not mandated to do that. Although HHI was required to appoint only one fourth of directors as outside directors at that time, CEO of HHI decided to appoint half of directors as outside directors in order to fully utilize outside director system as a mechanism for improving overall management.

One interesting features of the outside director system in HHI is that professional expertise rather than independence is given priority when selecting outside directors. Most of outside directors of HHI are professionals such as lawyers, financial experts, bankers and accountants. One of rationales for HHI considering expertise when selecting outside directors is that outside directors cannot be perfectly independent of the management with

any procedure of selecting outside directors, given that they are employed by the management. One of interviewee of HHI says that only reputation of outside directors can make outside directors independent from the management.

One of remarkable effects of outside director system of HHI belonging to the Hyundai business group, one of the biggest chaebols in Korea, is that affiliated firms of Hyundai Group began to maximize shareholder value of each firm rather than overall value of the Group. A sue by HHI against Hyundai Electronics and Hyundai Securities, affiliated firms in the same group, which is an un-precedent event in the past, reflects this trend.

Discussion

It is not easy to determine if outside director system has had any effects on the performances of Korean firms, given that such information is not easy to be revealed outsid e of the firms. Most of the staffs, we interviewed, whose job was to handle matters on boards say that they it was not easy to link overall financial performances of their firms to the role of the boards. However, our cases do show that outside director system often induce firms to make decisions in the interest of shareholders even if it does not affect performance directly. A sue by HHI against Hyundai Electronics and Hyundai Securities which are affiliated firms in the same group would have not happened if it had not been for outside directors. If it had not been for outside directors in the case of Kookmin bank, the bank would not have rejected the implicit order of government to purchase bonds of Daewoo group.

More visible effect of outside director system that is found in our cases is that boards get to play the expected roles. Boards of our cases used to play only the passive role of formally approving decisions made by CEO before the outside director system was introduced. This is particularly true of chaebol firms like SK telecom and HHI. Since the controlling shareholder of a chaebol has

de fact controls over all affiliated firms of the group, CEOs of affiliated firms of the chaebol does not have decision-making power. It follows that boards of chaebol firms were less independent and more passive than those of firms with diffuse ownership and professional management. Since outside director system was introduced, boards of our cases got to be more independent and play the expected role of monitoring and advising the management. As specific duties of board, committees and CEO are clearly defined, directors of boards of our cases tend to spend a lot of time discussing strategically important issues.

Another effect of outside director system is the enhancement of business transparency. Decision making process of our case firms got more transparent since the management of those firms should follow the procedures of explaining to board members how decisions were made. The case of Posco shows that since the outside director system was introduced, CEO could not make discretionary expenditures that had been possible to some extent without outside director system. Promises of donation by CEO have been rejected several times by outside directors since CEO could not justify them to the board members. The practice of unanimous decision making in the board could also enhance transparency of decision making since the management follow the process of revising a decision until outside directors no longer object to it.

The case of SK telecom shows that outside director system can enhance transparency of internal transactions among affiliated firms of chaebols. The practice of subsidizing affiliated firms by unfair transactions such as buying goods at higher price or providing debt guarantee at no cost disappeared since the outside director system was introduced. As internal transactions got more transparent, unnecessary conflicts among either affiliated firms or divisions of the same firm that had been common also disappeared. For example, the purchasing department of SK

Telecom used to buy equipments that were more expensive and did not meet specifications of ordering department from one of affiliated firms. As a result purchasing department were in conflicts with ordering department. As unfair transactions like this disappeared with outside director system, purchasing department restored good relation with ordering department.

Although boards of our cases studies are found to made some success in enhancing transparency through outside director system they still need to be improved in that directors lack independency and competency as a professional. As is the case in most chaebol firms in Korea it is very difficult to appoint outside directors independent from the management since the controlling shareholder of chaebols has controls over all affiliated firms and influence the appointment process of outside directors. Given that most firms have ownership structure similar to that of chaebol firms, the fact that the controlling shareholders of chaebol firms have controls over all affiliated firms might be one of local specificities that decrease effectiveness of outside director system in Korea. As for competency of outside directors, it is very difficult to find qualified outside directors in Korea since market for outside directors is not well developed in Korea. Professional managers have not been trained due to the chaebol regime where professional managers could not play their roles properly. It follows that underdevelopment of outside director market can be thought of as another local specificity that is not compatible with effective working of outside director system in Korea.

Ⅳ. Business Restructuring

Backgrounds

Before the crisis in 1997, the Korean economy was a symbol of high growth. Thus, the Korean firms had not experienced much restructuring of their business, namely the process of sell-

ing out, closing down, or reducing the unprofitable segment or subsidiaries. Although one of the basic principle of the management is the so-called 'build and scrap,' in Korea there had been only 'build' but no 'scrap.' For this reason, the 1997 crisis was a big shock for the business. Post-crisis business restructuring was initiated by the government. The so-called 'big deal' program was to implement business swap among the Chaebols, or big conglomerates. Although the amount involved was so big and thus it was thought the government had to play as intermediary, the government-initiated big deal had achieved only mixed results. For example, the sale of LG's semi-conductor line to Hyundai did not guaranteed the success of Hyundai and later Hynix after a name change, and the troubled Hynix used to be one of the biggest headache for the Korean economy although its performance has now made a stunning turn around since 2005.

As there were many criticisms for the government-initiated business restructuring, the government tried to take a different approach for those sectors which still seem to need restructuring. For the second rounds of business restructuring starting in early 2001, the government only designated the names of those sectors and decided not to direct any concrete or detailed ways to restructuring (see table 2). These sectors include chemical fibre, paper production, cement, agricultural machines and so on. While the situation of these sectors were particularly bad, there was not much market-driven restructuring in the form of M&A, divestment, or closing-down. Thus, the government wanted to something but there was really not much things to do, when they do not wanted be blamed again for "inefficient government intervention."

Table 2. Sectors designated for the two rounds of business restructuring

First round (1998. 9∼)	Second rounds (2001. 1∼)
Oil refinery	Chemical fibre
Semi-conductor	Cotton textile
Railway vehicles	Electrical furnace
Aircrafts	Paper production
Electrical power generator	Cement
Ship engines	Petro-chemicals
Petro-chemicals	Agricultural machines

• Source: Kim (2002).

However, the ‘voluntary restructuring’ was not easy, either. While the government wanted the firms to commit themselves to major hauling of their business, the firms were saying the without debt-equity swap or debt rescheduling or reductions, horizontal restructuring among the firms, such as M&A, would not happen. Commercial banks then said that without some words, even implicit signals, from the government, they cannot afford to give such favors as debt reductions or swaps and so on, and that it was better for the government to pour its own money to those troubled firms.

Below, we will see what went wrong in this second round of business restructuring with the paper production industry as a representative case.

The Story of the Paper Industry.[4.]

Paper industry was a mature industry in the late 1990s with an estimate of the sale growth rates in the next ten years of only 2.9% for the world market, and 3.5% for the Korean market. The share of paper industry in the Korean manufacturing is small (about 2% in sales volumes), Korean ranked in terms of production volume as the top ten in the world as of 2000. Since the

4. This part relies on Kim (2002).

1990s, Korean firms exported to world market with the USA and China as the main market, and paper has become one of the major export commodities. However, with the Uruguay Round Agreement in December 1993 and the beginning of the WTO era, world paper industry has been changing. There started a world wide fierce competition in a tariff free world. Moves to control the use of woods and forest in the agreement on global environment changes was an additional blow to the industry. For the Korean firms, it meant more trouble. The Korean tariff rates continued to decrease since the 1990s. It was 8% before 2001, and since then to become gradually reduced up to zero by 2004. With these changes, the Korean firms found more and more foreign products entering Korean market and their export market taken by Chinese or Malaysian firms.

There was world wide restructuring boom in paper industry, and its main form was M&A, although restructuring means also included strategic alliance and minor equity participation. Since 1993, the number of paper firms in the Europe and Northern America was reduced from 109 in 1993 now to 41. In Japan, the number of the firms reduced from 27 to 13. In Finland, the number reduced from the early 33 to now 2.5. In 2000, examples of M&A among the leading firms include: acquisition by the International Paper co. of the Champion International, acqusition of Donahu by Abitibi-Consolidated, and acquisition of Fletcher Challenge Paper by Norske Skog.

While Western firms focused on restructuring through M&A and reframe from expanding production capacity, the Korean firms had continued to expand the capacity throughout the 1990s with the capacity of 11,150,000 ton in 2000 more than doubled from the 1990 level. The average annual increase rate of production capacity was 0.4% in Japan, 2.2% in the USA, and 8.3% in Korea. Table 3 below shows the productive capacity and market shares of paper production companies in Korea. It is noted

that B and C companies increased most their production capacities. Production capacity aggravated seriously profitability of these firms as overall, domestic and international demand slowed down, relative to supply since the mid 1990s with 1996 turning point. The situation was further aggravated since 1999 when international prices of pulp and crude oil increased. As the market turned into a structural excess capacity and price decreased, the firm made losses and their debt ratio increased. In some firms, the debt-equity ratio reached 1,000 or even 30,000%. Some firms even ate away their equity capital.

Table 3. **Production capacity and Market Shares in Paper Industry in Korea**

(unit: 1,000 ton, %)

	Production capacity		Market shares	
	1990	2000	Domestic sale	exports
A Co.	172	274	10.3	9.7
B Co.	71	520	16.3	28.4
C Co.	188	520	17.5	16.5
Group (D,E,F Co's)	193	280	7.5	14.2
Group (G,H Co's)	136	415	12.9	24.2
I Co.	58	226	9.4	5.5
Sub total of 6 groups	818	2,235	73.9	98.6
Whole paper industry	1,187	2,869	100	100

• Source: From the association of the Korean paper industry, and from each firm. Recited from Kim (2002).

Korean firms had tried to deal with this situation in their own ways. The B company, which is the original parent company of the current B business group (Chaebols) and now the number one company in the industry, sold its factory producing papers for newspapers to the PAPCO, and, instead, the B participated as a shareholder of the PAPCO This is noteworthy since this company originally started with this single factory. The B also sold its factory in Shanghai, which also used to produce papers for news-

papers, and sold the production line for low quality papers. In the meantime, the B expanded the production line producing paper for general printing and plain white cardboard, and acquired a Hong Kong-based SCP company which produces plain white cardboard. It also sold its share in the troubled B-3 company and thereby separated the B-3 from its business group. With this shuffling, its main business had become papers for general printing and white cardboards, whereas it was papers for newspapers in the past.

This restructuring eased liquidity constraints of the B company and the B furthermore issued new stock and bonds to raise more funds. With this flow of money, the B wanted in early 2001 to acquire the number 2 company in the industry, namely the C company belonging to a different business group. If successful, this case would represent one of the most successful 'voluntary business restructuring.'

The C went into the workout program in October 1998 which is supposed to last until December 2004. One of the reasons for the failure of this firm goes back to its previous expansion that led the firm to liquidity crisis since 1997. Since then, it initiated its own restructuring program. Among its member companies, the group with the C-company as its core first merged the C-5 and C-6 companies, and it closed down the two factories with outdated facility. In 1998, it sold its Chung-won city -based factory producing papers for newspapers to the Norske Skog company in Norway. It also sold out real estates (lands or buildings) of the C-9, C-10, and C-11 companies, as well as security asset owned by C-12 company. Despite a series of measures, the company continued to make losses and the debt-equity ratio was as high as 30,000% as of end 2000. However, the C company opposed seriously the attempted acquisition by the B company, saying that it could make a quick turnaround if the business cycle changes and the merger would violates the anti-trust laws.

Besides the within-firm restructuring and failed M&A deal, the firms in this industry responded with strategic alliances as a part of their restructuring effort. For example, the B and H companies have signed an agreement of 'comprehensive strategic alliance' in February 2001. This agreement was to coordinate their production, marketing, procurement, and logistic. Their motivations were known to overcome the limits of within-firm restructuring by affecting the market with some coordinated actions among the players.

Another case of strategic alliance was found among the relatively minor companies, A, C, and D. They agreed to exchange their products after each specializing producing its own kinds of papers in which one has comparative advantage. A total volume of mutual swap is amounted be 60,000 ton, and it is expected to have the effect of production reduction and import substitutions.

Discussion

Even though the C company was already under the 'workout' program and continued to be in bad situation, the merger deal was not realized. First, the debt-holder banks with the Cheil Bank as the leader were not enthusiastic about the acquisition since their loans were backed by collateral and there were no initiatives from the government to share the responsibility and risk. On the other hands, the government unit in charge of the 2nd business restructuring, was happy to see the moves, but made it clear that they would not be directly involved. Furthermore, there was no effort to address the issue of giving or not tax benefits associated this possible acquisition and the possible anti-trust issues of this acquisition case.

A more fundamental issue in this regard was the deficiency in market infrastructure including the lack of intermediary bodies, corporate governance issues and the related transparency problem in the firm. First of all, since information revealed in the

accounting books of the firms are neither accurate nor reliable, it cannot serve as the basis for price negotiation in the M&A deal. While this is the first and immediate source for the price haggle, another source is the high premium for the management control rights. Since the corporate governance is not clear, there exist diverse channels for expropriation of company resources by the controller, the so-called "tunneling."[5.]

This is possible since many big firms in Korea are of the controlling minority structures (CMS). Bebchuk, Kraakman, and Triantis (2000) find that in a CMS firm, a shareholder or a group of shareholders exercises control while retaining only a small fraction of the equity claims on the company's cash flow. Such a radical separation of control and cash flow rights can occur in three principal ways: through cross-ownership ties, through a dual-class share structure, and through stock pyramids. In other words, the stakes are very high for the controlling management. Thus, they wanted to maintain their control over the firms unless they are paid substantial premium.[6.] For these reasons, the two sides tend to find it difficult to agree upon the prices of the target.

While this case shows the limit of the so-called 'voluntary restructuring' without direct government involvement, it also exemplify the market failure in the sense of the lack of intermediary vehicle to facilitate M&A and sale of the firms. This boils down to the question of efficiency of overall capital market in Korea. To put it simply, restructuring market is very thin in Korea without various supporting institutions. Although the CRF (corporate restructuring funds), CRC (corporate restructuring company), and

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5. Joh (2003) finds by an empirical analysis using the firm data that in Korean firms, separation of cash flow rights from control rights led to low profitability, suggesting the effect of agency costs of the controllers.
6. See Bebchuk, Kraakman, and Triantis (2000) for more details.

CRV (corporate restructuring vehicle) have all been introduced in Korea since September 1998, February 1999, and October 2000, respectively, they yet have a long way to go before fully functioning.

The literature classifies business restructuring into intra-firm and inter-firm restructuring as shown in figure 1. This study also finds that in Korea business restructuring tended to take the form of weaker forms, namely mostly intra-firm restructuring and some strategic alliances, but few M&A's. This has to do with the above-mentioned feature of insufficient market institutions, but also with the prevalence of group-style firms in Korea. Since many firms are a affiliated firm of one business group or another, the restructuring proceeds driven by the group-level considerations, rather than at the level of each firms, which makes the process more complicated and thus end up "intra-group" restructuring.

Figure 1. Various Means of Corporate Restructuring

Intra-firm Restructuring: asset divestiture, spin-off or separation of divisions/units, selling off or combination of divisions or subsidiaries, workforce downsizing, plant closing, inducement of foreign funds

Inter-firm Restructuring :

1) Weak involvement: strategic alliance (joint development, cross-production, joint marketing and procurements, and agreement to production reduction).
2) Strong involvement: M&A, P&A, business swaps, joint venture

Source: Kim (2002)

The above discussion signifies again the tension between global standard and local specificity. In the early state of reform, the government was directly involved in the business restructuring, with the so-called "big deal" program, and such direct invention was harshly criticized violating the principle of free market. But, the above story of business restructuring also re-

vealed the limit of the market-based approach. This point is not to blame the market-based or global standard approach itself, but rather to emphasize the need to address certain necessary conditions for such approach to be effective, or equivalently the importance of local specificity. We first noted the insufficient development of intermediary vehicle to facilitate M&A and sale of the firms, and then pointed out the extra premium attached to the owner-controllers' of the firms associated with the opaque nature of corporate governance. While the transparent governance is an universal value, the existence of controller's premium suggest that this part should be tackled first before we take the "market will do the job (M&A)" attitudes.

Ⅴ. Conclusions

This paper has investigated institutional changes in corporate sector in Korea with a focus on the issue of transparency. The following three areas of institutional reform have been covered by the case studies of the relevant firms: 1) workforce restructuring in labor-management relations, 2) independent directors in corporate governance, and 3) business restructuring. These were key institutions, which were one of the most critical elements in post-crisis reform in Korea, and transparency has been the key issues in all of these institutional reforms.

In workforce restructuring, the paper finds that if there was more trust between the management and labor and more transparency in the firm management, the both sides would have avoided or at least saved substantial costs incurred during the restructuring process. However, the issue of management transparency goes beyond the level of the labor-management conflict to the level of the top level governance. Only when a good corporate governance system is in place, one can expect transparent management and information disclosure to the labor side. Only after

than, a more efficient and less costly bargaining between the labor and management can prevail.

In corporate governance reform, introduction of independent directors was a hot issue. While it is not easy to judge if outside/independent director system has had any significant effects on the performances of Korean firms, however, our cases do show that outside directors affected firm behavior in several important respects. First, it induced firms to make decisions in the interest of shareholders even if it does not affect overall performance directly. More visible effect of outside director system was that now board members were getting to play the expected roles as stipulated by the laws. Another effect of outside director system is found to be the enhancement of business transparency. Decision making process of our case firms got more transparent since the management of those firms should follow the procedures of explaining to board members how decisions were made. The case of SK telecom shows that outside director system can enhance transparency of internal transactions among affiliated firms.

The paper also finds that corporate governance affect the process of business restructuring in Korea. Opaque corporate governance tend to make higher the premium of managing controller, and thus the controller does not want to sell his company unless one is paid enough price to compensate for the premium. Such situation makes M&A difficult to happen due to the haggle around the correct prices of the target firm or business units. Transparency issues also involves business restructuring since, without transparency in book keeping, the traders cannot agree upon the true state of the target firm and thus the price of the firm.

In sum, this paper first confirms the importance of 'transparency' in corporate management and institutions as one of the most fundamental requirements of the market economy and second, the

importance of how to handle some tension between the global standards and local specificity in corporate reform. The paper has argued that emphasis on flexibility as a global standard in labor markets tend to result in segmented labor markets when it faces with local specificity of strong labor unions. Emphasis on market-based corporate restructuring as global standard in restructuring might not work well, given the local specificity of opaque corporate governance which accord high premium for the controlling management. Also, introduction of independent directors as a global standard in the board might have limited impacts when there is strong and long-term owners in place to keep personal control over the firms (local specificity). One possible limitation of this study would be that the case studies information was collected based on the situation immediately after the reform and thus does not fully reflect long-term consequences of the reforms.

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