

RESTRUCTURING OF KOREAN SECURITIES INDUSTRY

Necessity of Restructuring

The Korean stock market in 1994 was the 7th largest in the world in terms of trading volume, and it has become a major world stock market. Foreign investors can invest up to 15% of the total capitalization of the Korean stock market, which was opened to them in 1992. Their investment has contributed to strengthening the Korean stock market. The opening of the Korean stock market to foreign investors is expected to be even wider and it will make the Korean stock market more globalized.

In spite of this development, 32 domestic securities companies have been so accustomed to a narrow-minded and passive management that they may not be able to take advantage of the expanded Korean stock market under the global economic environment. Unlike other sectors of the economy, the domestic securities firms have grown up with little competition and have not pursued specialization in specific business areas. They did not even have to specialize, since it was not difficult for them to make money from the stock market without much effort. Their business areas were almost identical, mainly brokerage so that they were not challenged to develop new financial products, or to innovate. Due to the stagnant market share and weak profit structure in recent years, domestic securities companies' earnings have been unstable and highly dependent on the stock market cycle.

Because of the inefficient direct financial market, Korean securities companies are not able to compete with the foreign firms and support consistent economic growth for the country. Therefore, it is necessary for the Korean securities industry to be restructured prior to Korea's joining of OECD.

Moving Toward a Universal Banking System

The government-commissioned Securities Industry Restructuring Committee proposed several plans to restructure the securities industry, namely by breaking down a business barrier inside the industry itself. The Ministry of Finance and Economy will develop its own policies based on the committee's draft by the end of August and will implement them starting next year after having revised the proposed securities act at this autumn's National Assembly. The committee's draft is based on the desirability of phasing out business barriers in the financial market. However, the level of restructuring is not drastic enough to meet the demand for financial market's innovation.

At the initial stage, banks, securities companies, and insurance companies will be allowed to do each other's business through their subsidiaries. The next step may be the merger of merchant banks and securities companies to form investment banks. Efforts to break business barriers have contributed to the gradual move toward the universal banking system. For example, it is expected that securities companies will be able to handle fund management while investment trust companies will be allowed to deal in securities. However, the business boundaries between banks, securities and insurance will be maintained.

Effects of the Reform on the Financial Market

The efforts to phase out business barriers in the financial market have been made to improve the level of market efficiency through competition. New financial products to attract customers will be introduced by many financial firms. Due to the discretionary nature of investment business, frequent conflicts between customers(investors) and financial firms can be expected. Further competition will build up a kind of natural selection among many medium and small sized financial service firms. Thus, investors might have a credit risk, financial as well as moral, that an obligation may not be

paid resulting in a loss.

However, instead of paying for risk, customers will have better financial services and more opportunities to invest than in the past. To prevent investors from losing their financial assets, careful administrative inspection and monitoring should be conducted. In sum, investors have to consider the management stability(credit) as well as the service quality of each financial firm in selecting their financial service firms, in order to benefit from the nation's cautious move toward a universal banking system.

(Kim Hee-Seong)

Reform of Compartmentalized Financial System

Financial Services Firms

Main Contents of the Draft

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| Securities Companies | * Set up investment trust company as a subsidiary company
* Restrict its ownership to a single person |
| Investment Trust Companies | * Set up subsidiaries handling securities business either by separating their existing sales networks or by newly establishing specialized brokerage houses |
| Merchant Banks and Leasing Firms | * Handle bond-type investment trust instrument either by establishing subsidiaries or directly |
| Investment Advisory Companies | * Deal fund management business or provide discretionary investment business on behalf of customers |