THE ECONOMIC ENVIRONMENT AND BUSINESS STRATEGIES IN THE "IMF ERA"

by Hong-Rae Cho

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The Macroeconomic Background

In order to figure out what business strategies in Korea for 1998 should be, one needs to understand, first of all, the macro-economic environment that Korea will face. According to the agreement between the Korean government and the IMF, the Korean economy will have to experience a low-growth, high-unemployment, and high-interest-rate situation in 1998. Economists at the IMF think that the basic cause of Korea's current economic crisis is the accumulated current account deficit. And by holding its annual growth rate to under 3%, which is less than half of 1997's, they believe that Korea's current account deficit will improve dramatically, down to less than 1% of its GDP. To reach this goal, the Korean government should take every policy measure and, if necessary, allow harsh conditions such as an unemployment rate of 5% and tight monetary policy with interest rates higher than 15%. In 1998, Korea's financial industry will undergo unprecedented reform as well. Several commercial banks or merchant banks, which have extremely big amounts of bad and unperforming loans, will not be left many choices but shutting down their businesses or aggressively seeking patrons for friendly M&A's. Due to the rising unemployment and stringent financial market, both domestic demand and facility investment (which means demand for capital goods) will show very sluggish or even minus growth.

The Bigger Picture

But the general outlook on the world economy appears far better than that on Korea. Most of world's leading economic forecasting agencies anticipate that the world economy in 1998 will grow by 3% in real terms, while its trade volume will expands by more than 7%. Developed countries have brighter prospects than developing countries. The U.S. is surely going to extend its growth into 1998, and other developed countries including Japan and Western Europe are likely to post growth rates higher than those of 1997. The worldwide supply-demand conditions in major industries are expected to be favorable to Korean exporters: these industries include semiconductors, shipbuilding, steel, and petrochemicals.

The new policy agenda of Mr. Kim Dae Jung, the president-elect, will be another important factor which determines the economic environment in Korea. Since Mr. Kim has traditionally taken quite liberal positions on major economic problems, many observers expect that his administration prefers economic reform to the status quo, and is likely to impose new series of industrial policies which Korea's big business groups ('chaebols') would find hard to conform with immediately. Loosening the close ties among member companies within a big business group and supporting small businesses will be core components in his economic reform program. Every corporate manager in Korea should take a closer look at these macro-economic and policy trends in 1998 more than ever.

Bad Corporate Habits & A Healthy Financial Structure

For businesses trying to overcome current difficulties, it is pretty helpful to understand the similarities among the Korean firms that went bankrupt in 1997. Most of these firms completed large-scale facility investments in the last several years; these investments were financed by bank loans, rather than by capital increments. Therefore when the business cycle turned downward from mid-1996, they began to face mounting financial pressure. Another common characteristic among these firms is their ill-advised diversification strategies. For instance, a big business group that went bankrupt once branched out into the construction business and steel industry in a large scale while its core competence lay in the auto industry.

To keep a healthy corporate financial structure is of the foremost importance for all businesses in 1998. The liquidity shortage situation in the financial market will continue throughout the first half of this year. And with annual interest rates around 20%, no firm can survive the financial pressure if its normal business operation heavily depends on debt. Every corporate manager, while lessening debt burden, should secure proper ways for stable cash flow or seek opportunities for direct financing through the stock market. The most sensible and probably the easiest strategy in this context would be a thorough review and postponement of investment plans especially if they were to be financed by outside sources.

In the next several months, the domestic financial market will be opened to foreigners to a greater extent. Also, regulations governing Korean firms' direct or indirect offshore financing are being lifted. These trends mean, at least in the long run, that the opportunity for low-cost financing is being opened to Korean firms more widely. But this is true only when a company has acquired proper credibility in the market. Therefore, big businesses in Korea should enhance their credibility by providing consolidated balance sheets and by acquiring credit ratings from responsible credit rating agencies such as Standard and Poor (S&P) and Moody's.

Shrinking domestic demand for both consumer and capital goods will lead Korean firms to export-oriented strategies. As mentioned above, the market conditions abroad are become more favorable to Korean industries. Moreover, since the beginning of 1997, the value of the Korean won has depreciated by 80~90% against the U.S. dollar and by 60~70% against the Japanese yen. Because Korea's major export goods are competing mainly against Japanese products abroad, the weak won is extremely encouraging news to major industries. Before the domestic financial market gets stable, however, many exporters will encounter difficulties in their export finances due to the liquidity shortage. By utilizing foreign banks as financial sources, they should be able to overcome this bottleneck.

The Bottom Line: Restructuring

For many Korean firms, restructuring is the most fundamental solution to the present crisis. As IMF strongly recommends an overall restructuring in the Korean economy, more firms will go bankrupt in the coming year. A business unit, if it is not able to earn enough cash flow to cover its operational costs, cannot survive the 20% + interest rates and tight financial market. In every aspect, a corporate manager cannot afford to hold a 'bad sector' within his firm any more. A set of good or promising sectors must be selected and all business resources must be concentrated into them. Sell-offs, M&As, shutting-down and other methods can be used to 'trim' the remaining business sectors. Since restructuring is usually accompanied by layoffs or wage cuts, how to minimize the pain among company workers is the most important task for corporate management in 1998. VIP

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