THE NEED FOR CORPORATE RESTRUCTURING AND WHAT THE GOVERNMENT SHOULD DO

by Hong-Jin Park

"Increasing globalization with the launching of the WTO regime made it no longer possible for Korean businesses to reap monopolistic or oligopolistic profits under a non-competitive industrial structure."

"Their stubborn clinging to their past growth strategies in spite of the dramatic changes in the economic environment weakened their profitability and adaptability."

The End of the Myth of the Big Businesses

Up until now, Korean big businesses believed in a certain myth—that they would never go belly-up. Last year, however, six of the top 30 business groups—Kia, Hanbo, Halla, Jinro, Haitai, and New Core—succumbed to bankruptcy. The myth of the chaebol, long regarded as the symbol of Korea's economic success, is now falling apart.

Starting in the latter half of the 1980s, as the advanced economies slowed down, the Korean economy reached the limits of its high growth rates, and the era of corporate growth based on expanding one's size and market share began coming to an end. In addition, throughout the world, technology and product life-cycles became increasingly shorter, and control of the market switched from producers to consumers. At the same time, increasing globalization with the launching of the WTO regime made it no longer possible for Korean businesses to reap monopolistic or oligopolistic profits under a non-competitive industrial structure. Moreover, they could no longer count on Korean consumers to systematically prefer domestic products.

In spite of all this, a large number of big businesses stuck to the usual production and market strategies of acquiring standardized technologies and mass-producing final products to be distributed in the domestic and overseas markets in large quantities. Also, the big businesses persisted in their outward-oriented growth strategies, which developed in the course of trying to become the market leader in as many areas as possible at a time when imports were restricted and competitors were few in the domestic market.

Their stubborn clinging to their past growth strategies in spite of the dramatic changes in the economic environment weakened their profitability and adaptability. The reality is that last year the profit margin of the top 50 business groups was only 0.2%.

Therefore, for Korean big businesses to survive, they need to strengthen their competitiveness by moving away from their "fleet" style expansion-oriented management and pursuing restructuring in earnest.

The IMF's Demand for Improvement of Big Businesses' Management Structure

The IMF regime shall prove to be a watershed in promoting change in big businesses. In return for providing Korea with emergency rescue funds, the IMF demanded that the Korean government adopt an extremely tough big business policy, including such measures as the mandatory provision of consolidated financial statements, prohibition of mutual debt repay-ment guarantees, and permission for hostile M&As. These demands herald sweeping changes in the structure of big business groups.

If mutual repayment guarantees are abolished, the less financially stable subsidiaries of big businesses will not be able to survive, since they will not be able obtain money from financial institutions based on the guarantee of more financially stable subsidiaries. In addition, cross repayment guarantees among the top 30 business groups totalled 33.15 trillion won as of April 1997. This represents the equivalent of 47% of their capital (70.46 trillion). To alleviate this situation, each business will either have to make a lot of money through exports and change their financial structure or get rid of unprofitable businesses.

If consolidated financial statements become mandatory, one would be able to easily see the mutual repayment guarantees and internal dealings among subsidiaries. Business management would become transparent, and it would become impossible to artificially inflate sales figures. In the end, big business groups would have no choice but to restructure around their major business lines.

If hostile takeovers are allowed, big businesses might find themselves in an emergency to defend their management rights. Among the listed companies among the top 30 business groups in Korea, the average internal shareholding amounts to only 26.6%. Especially because stock prices have plummeted and the exchange rate has shot up rapidly, foreign investors will be able to acquire superior companies at relatively cheap prices. To prepare for the possibility of a hostile M&A, big businesses need to secure enough capital to defend their management rights through restructuring measures such as disposing of marginal businesses and unneeded assets.

On the other hand, the IMF has demanded high interest rates with call rates of over 30% in order to improve the profitability of the domestic financial industry. If the average interest rate for this year were to remain at 20%, it is estimated that the top 30 business groups would lose a minimum 14.4 trillion won if sales stayed at the same level and a maximum 18.4 trillion won if sales dropped by 3%. Therefore, to minimize the loss caused by the high interest rates, each business must quickly improve its financial structure by disposing of marginal business and reducing their borrowing.

Role of the Government in Restructuring

In the past, it was the Korean government, that really led the private economy. Armed with a wide array of policy measures, the government not only set the pattern for economic development but also provided the financial resources and decided which firms would be allowed to enter certain businesses and which technologies should be acquired. Bank loans would be made at the word of the government. Under this environment, the Korean business groups developed distinctive characteristics such as excessive borrowing, business diversification, and cross debt guarantees among subsidiaries, which enabled them to maximize profits. Therefore, one can say a certain degree of responsibility for the current problems with big businesses lies with the government and banks.

For this reason, the government must play a primary role in solving the problems of the big business groups and restore their competitiveness through restructuring. In other words, the government must provide an incentive-filled

"To prepare for the possibility of a hostile M&A, big businesses need to secure enough capital to defend their management rights through restructuring measures such as disposing of marginal businesses and unneeded assets."

"One can say a certain degree of responsibility for the current problems with big businesses lies with the government and banks."

"The U.S. government focused on deregulation, providing laid-off workers with job re-training, expanding social overhead capital, and providing incentives for private investment into fostering human resources, advanced technologies, and other promising sectors."

"Firms should be allowed to restructure in a manner of their own choice, whether it be a Big Deal, a strategic alliance, a joint venture with a foreign firm, or disposing of subsidiaries."

environment and strictly follow market principles.

Creating an incentive-filled environment entails revising the various institutions and systems which are hindering restructuring efforts. The government should eliminate the excessive taxes imposed when selling off assets, the regulations on investment in other firms under the Fair Trade Act, and prohibition on business' joining together. It should also allow businesses to layoff workers in the course of restructuring and downsizing.

The government should also create an environment in which non-competitive firms are weeded out or taken over through M&As. Financial institutions need to be given more autonomy so that they can make loans on the basis of strict screening procedures.

The United States serves as a model on how Korea should restructure. In the U.S., firms within an industry were not divided into winners and losers, with resources being focused on the former. Instead, restructuring took place on the basis of their market competitiveness. The U.S. government focused on deregulation, providing laid-off workers with job re-training, expanding social overhead capital, and providing incentives for private investment into fostering human resources, advanced technologies, and promising sectors.

The role of the Korean government should be to ensure that firms are allowed to enter and exit the market based on the market mechanism and the principle of competition, leaving the exact details of restructuring up to firms themselves.

In particular, it is extremely dangerous for the government to directly intervene in the investment decisions and activities of firms in the name of preventing overlapping or excessive investments. The new Administration's efforts to push firms to restructure through "Big Deals" is an example of this. By their very nature, Big Deals require a great deal of secrecy and a long period of time. If news of a Big Deal became known, immediately the creditors of that firm would start calling in their loans, the normal dealings with suppliers and distributors would stop, workers would become agitated, and productivity would decline. If the Big Deal failed to go through, it would leave devastating scars. In addition, it would take more than a year to accurately figure out how much a target firm's assets are worth, what to do with its employees, and how to deal with its complicated ownership and financial structures. Furthermore, it is questionable as to whether the new firm which emerges from the Big Deal would be internationally competitive. In the case of Germany, huge monopolistic firms emerged after restructuring in the shipbuilding, steel, and electric industries, but after a while, their international competitiveness was weakened.

If the government tries to force through these Big Deals in a short period of time, there is a huge possibility that in the end firms will be less competitive.

Accordingly, the government should strictly follow market principles and allow firms to be autonomous. Firms should be allowed to restructure in a manner of their own choice, whether it be a Big Deal, a strategic alliance, a joint venture with a foreign firm, or disposing of subsidiaries. If the government feels that the restructuring plans of big businesses are lacking, the proper economic solution should be for the government to apply pressure through institutional changes which will make it impossible for firms which fail to restructure to survive. VIP