AN ANALYSIS OF THE KOREAN M&A MARKET

by Chan-Jin Kim

In Korea, mergers and acquisitions (M&A) were very uncommon until April 1, 1997. Basically, many did not think about the importances of M&As. However, since then the government policies toward M&As have changed[1], and M&As have now become a major concern of majority stockholders as well as investors. Furthermore, since the limit on foreigners' stock ownership was increased to 55 percent, the possibility of M&As is likely to rise. Before considering the prospects of the Korean M&A market, it is a good idea to first review M&As in general.

There are many reasons for M&As to occur, and several different motives will simultaneously influence the behavior of those parties involved in the M&As. The first motive for M&As is a normal business motive such as achieving economies of scale or scope and reinvestment. Vertical mergers are also executed because of normal business motives.

The second motive is the monopoly motive. For example, horizontal mergers and massive consolidation usually result from the motive to achieve monopolistic power, However, most countries regulate these kinds of mergers through antitrust laws to avoid inefficient monopoly profits for merging firms.

Another motive, which was the most popular in the U.S. in the 80s, is the speculative motive that was easily realized by the development of financial facilities and instruments as well as financial engineering.

Since the Korean government will allow even hostile M&As (except for defense and strategic firms) by foreign firms and investors (including institutional investors) this year, the possibility for almost any kind of M&A[2] will undoubtedly increase.

After foreign currency crisis in last November, the government became aware that it needed to attract foreign direct investment (FDI) and therefore decided to relax the regulations related to M&As[3]. However, in order to avoid an abrupt change in corporate governance, which had been protected until then by the strict regulations on the equity shares of third parties, the government decided to give enterprises a grace period until sometime this year to defend against hostile M&As by themselves.

Even with this grace period, many more M&As can be expected this year compared to previous years because many have come to understand the importance and necessity of M&As in light of the current economic situations. Immediate restructuring of the overall Korean economy is needed to it to transform it into a low-cost and high-efficiency structure.

The lowered costs of M&As are the most attractive factor at this time. In particular, the cheap prices of equity per share and Korean won could interest foreigners to think about M&As for either pushing into the Korean economy or only making investments (possibly specula-

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1) With the revision, anyone can now buy more than 10 percent of the total equity of one company.
2) Last year a few friendly M&As by foreign enterprises took place.
3) The foreigners are no longer need approval from the Ministry of Finance and Economy when they buy any firm whose asset value is more than 2 trillion won. Foreigners will not need to get approval from the incumbent corporate management when they buy less than 33 percent of the equity stake of a company, up from the current 10 percent.

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tion) profits in the short run. However, as shown in Table 1 below, there are several factors which might reduce the possibility of M&As — for example, the lack of managerial transparency and the unstable economic environment.

Now, it is time to look at the Korean M&A markets. As it is well known, business group owners and other major shareholders own an average of 20 to 25 percent or so of the shares of their listed subsidiaries. Since foreign companies (also other domestic companies) are able to own 33.3 percent of a company without the approval of the board of directors, they can easily pursue M&As if they have enough capital or funds.

Most likely, nobody will be interested in small companies with little potential. The companies with the highest potential for being M&A targets are those that have a high value of assets, some monopolistic power of distribution or production, some distinguishing technology or some holding companies. Until now, foreigners' shares of equities for each individual company have been generally concentrated in companies with high potential.

After the new legislation allowing hostile takeovers of domestic firms by foreign investors goes into effect in this year, M&As of such high potential companies mentioned above will occur more frequently. Furthermore, in the Mexican[4] experience, cross-border M&As started to occur more often a half year after asking for the IMF bailout loans. Thus, it is likely that the Korean M&A market will become more active along with the stock market.

To achieve successful restructuring of the Korean industry and to induce stable foreign capital into the domestic market, the following improvements are needed: the solidification of public announcements, strict regulation and punishment of insider trading, and deregulation of financial market. All these improvements will lead to a more efficient financial market and will help the Korean economy escape the current economic crisis. In other words, more open minds for M&As as well as the successful readjustment of Korea's financial systems and environment will stimulate the Korean M&A market this year, which should please investors[5] VIP

〈Table 1〉 Current Factors Influencing Possible M&As in Korea

Positive Factors for M&As	- Devaluation of Korean Won against U.S. Dollar - Lowered Stock Prices - Deregulation for M&As - More Open Minds for M&As (Easing of Public Opinions against M&As)
Negative Factors for M&As	- Lack of Managerial Transparency (Difficult to Calculate Real Value of Companies) - Unstable Economic Environments (High Probability of Default)

4) Mexico asked IMF emergency loans in 1995.

5) From previous experiences, the activities of M&As influenced the stock prices strongly, especially the stock prices of acquired or target firm would rise sharply until time of merger announcement.