

BOTTLENECKS IN BUSINESS GROUPS' RESTRUCTURING

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The Current Status

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The main causes behind the current Korean economic crisis were the excessive government intervention, the inefficient financial system, and firms' over-reliance on debt for their management. Accordingly, to overcome the current crisis, Korea must move away from a government-led economy, weed out insolvent financial institutions, promote self-regulation, and pursue business restructuring.

In light of the current conditions, corporate restructuring is a critical task for survival. Interest rates are high, the financial market is sluggish, the domestic market is depressed, and practices such as mutual repayment guarantees are being eliminated. Therefore, big business groups are now pursuing restructuring through the sale or merger of subsidiaries and the sale of assets such as real estate.

But in truth, actual progress has been somewhat slow. There have only been a few cases of the sell-off of subsidiaries or business lines. Hyundai Electronics Industries sold the local American firm Symbios, while the Daesang Group sold its lysine business line and Samsung Heavy Industries Company sold its heavy equipment division. Regarding the merging of subsidiaries, there have only been six reported cases of mergers among listed companies, while there have been 21 cases of non-listed firms registering to merge with listed companies. In addition, almost none of the real estate put up for sale by the top 30 groups, worth about 17 trillion won, has been sold.

This sluggishness in business groups' restructuring is partly mirrored in the flows of foreign investment. For the year, foreign funds coming into Korea have totalled 4.3 billion dollars. However, most of that is hot money for the stock market; investment related to restructuring has only amounted to about \$500 million dollars.

Policy Confusion About Business Groups' Restructuring

Why is corporate restructuring proceeding so slowly even though the government and businesses both realize that business restructuring is such an urgent task? Above all the main reason is confusion concerning the policies related to business groups' restructuring.

The first example of such confusion is the government's policy to have business groups lower their debt-equity ratio to under 200% in order to promote restructuring. At present, the total capital of the top 30 business groups amounts to only 68 trillion won, while debts total 424 trillion won for an average debt-equity ratio of 616%. If the top 30 groups are to lower their debt-equity ratios to under 200% by next year, they must either pay back 219 trillion won worth of debt or issue 110 trillion worth of new equity.

Considering the fact that last year total paid in capital increases and new stock issuances only amounted to 3 trillion won, big business groups would have no choice but to sell off subsidiaries

or assets. For them to cut their debt-equity ratio to under 200%, the top 30 groups would have to lower the number of their subsidiaries from the current 804 to about 100.

If big business groups were to sell-off such a huge number of subsidiaries all at once to decrease their debt ratios, the bargaining power of the supply side would be greatly weakened, and the demand side would delay purchasing because of expectations that prices would continue to fall. Accordingly, trying to reduce the debt-equity ratio in such a manner would not promote business groups' restructuring but would actually delay the process.

In addition, given that business restructuring is only focusing on the sale of subsidiaries or assets, firms do not dare to think about facility investment. According to the Industrial Bank, facility investment planned for this year is estimated to drop some 30% this year to almost 36 trillion won. Many are worrying that such a reduction in facility investment will prolong the economic depression.

The second area of such confusion is the friction between the government's business restructuring policy and its unemployment policy. The government is strongly demanding that businesses restructure, yet at the same time, it is insisting that massive layoffs be avoided as much as possible. If the government tries to prevent layoffs and demands that employees be retained in the course of M&As for the sake of minimizing unemployment, business groups' restructuring will inevitably be delayed and foreign investors will continue to shun Korea. Also if the government tries to use its limited financial resources evenly on its business restructuring policies and unemployment measures, the results will not be very

promising.

Judging from the example of the advanced countries, the basic thrust of the government's unemployment policy should not be on artificially trying to maintain employment levels, but on trying to create new employment by stimulating the economy and minimizing preventable unemployment by preventing the bankruptcies of profitable firms and boosting the domestic market. An unemployment policy designed to artificially maintain unemployment levels cannot be allowed hold back the process of restructuring. The best way to minimize the period of pain is to quickly set up the springboard for economic recovery through business restructuring.

A third problem is reverse discrimination against domestic firms. Attracting foreign investment is essential for overcoming the foreign exchange crisis and obtaining the financial resources necessary for restructuring, and the government is boldly removing obstacles to foreign investment. However, in the course of this, the problem of reverse discrimination against domestic firms is emerging. Most of the reverse-discriminatory regulations are concentrated in the Fair Trade Act regulations, which are designed to prevent an excessive concentration of economic power. Domestic big business groups are being fettered by regulations prohibiting of holding companies, cross-investments among subsidiaries, and entry into 87 business areas designated for small- and medium-sized enterprises (SMEs), but foreigners are excepted from these. In a completely opened domestic market, a system designed to prevent the economic power concentration of big business groups is no longer meaningful. To promote corporate restructuring, the government

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should boldly loosen such reverse-discriminatory regulations.

Policy for Business Groups' restructuring

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Recently the government announced that in order to promote business restructuring, it would focus on improving the conditions for capital increases, transforming short-term debt into long-term debt and promoting the sale businesses' real estate. Toward this end, it will establish a business restructuring fund worth about 10 trillion won, issue real estate investment trust goods and asset-backed securities, and introduce a system of companies specializing in restructuring.

The business groups' restructuring fund will be composed of two kinds of fund—a stock-investment fund and a debt-restructuring fund. Those funds will be established in June, capitalized at 1 trillion won each and to be expanded to 10 trillion won within this year. The role of the stock-investment fund is to supply long-term and stable capital to middle and small firms by buying stocks of those firms. The role of the debt-restructuring fund is to transform short-term debt into of those firms long-term debt.

Also to promote the sale of real estate the government announced measures like the Korea Land Company's purchase of real estate by issuing 3 trillion won worth of bonds, the issuance of asset-backed securities and real estate investment trust goods, reduction of real-estate-related taxes and permission of foreigners' purchase of land.

These policy measures to promote corporate restructuring should help to vitalize restructur-

ing since they contain concrete measures. But their success or failure will be dependent on how much foreign capital inflow can be attracted. Given this fact, one problem with the government's policy is that the restructuring funds will only be targeted at supporting medium and smaller-sized firms, which will limit the size and scope of foreign investment to be attracted.

Breakthrough in Restructuring Needed

The slow progress in business groups' restructuring is making it difficult to overcome the economic crisis and alleviate the problem of unemployment. Under these circumstances, what measures should be taken to overcome this situation?

First, the government should clearly define the objective and blueprint of its policy on business groups' restructuring. The uncertainty as to whether the objective of restructuring is to improve businesses' competitiveness or to break up the big business groups is causing policy confusion, making it difficult for firms to make up detailed restructuring plans under a long-term vision. The goal of the restructuring policy should be to enhance business competitiveness. Reduction of the debt-equity ratio or the number of subsidiaries should not be the goal but the by-product the business groups' restructuring. Therefore, the government should quickly make clear the objective and blueprint of its corporate restructuring policy and thereby minimize the reform energies being wasted because of the misunderstandings between the government and businesses

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