

HOLDING COMPANIES IN KOREA : NEW TREND

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Holding Companies are relatively new

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Holding companies are likely to become a new paradigm in Korean business. This new change is very unfamiliar to Koreans because, until April of last year, holding companies had been legally prohibited for a long time. Though the corporation system has existed in advanced countries for many years, it has not been allowed in Korea because conglomerates can take advantage of the system to expand into unrelated businesses.

Under the Monopoly Regulation and Fair Trade Act which was revised last year, a holding company must have a debt-to-equity ratio of less than 100 percent and have more than a 50 percent stake in their affiliates. The affiliates are not permitted to have subsidiaries of their own. Among the affiliates, cross-payment guarantees are prohibited and in the case of a financial holding company, financial connections with non-financial firms are strictly prohibited.

Establishing venture holding companies

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Recently, in Korea, there have been two trends in establishing holding companies: Venture holding company and Financial holding company.

Many large corporations such as Samsung Corp. SK, and Kolon International Corp. are realigning their operations to turn into venture holding companies. By setting up venture funds and breaking away from their current businesses that have reached growth limit, the big firms are now seeking new business opportunities and profit sources.

Samsung Corporation will change itself into a holding company with 20 companies and 100 subsidiaries at home and abroad by the year 2005. Samsung Corp. has introduced the division company (DC) system in the trading sector first and reorganized its sales department into six DCs such as the Internet, chemicals, information, and communication and machinery equipment. The DC system requires each DC to conduct self-management like an independent company, with management rights going to the head of the DC.

SK has also emerged as a holding company for the entire SK group. The fourth largest conglomerate has classified its affiliates largely into four major fields:

finance, telecommunication, energy, and others. Especially, SK-Enron Corp., a company set up jointly by the SK Group and Enron of the United States, will be a new pure holding company in the field of energy. The company has reportedly already satisfied all the conditions of a holding company, controlling the SK Group's gas distribution operations.

The new move to set up holding companies has not been restricted to large firms. In the non-financial sector, C&M Communications is expected to become the first holding company. Previously, the parent company was a wholesaler for stuffed dolls. Now, C&M as a pure holding company will enter into new businesses like broadcasting and communication by acquiring nine local cable broadcasting companies.

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Further, Masayoshi Son, CEO of Softbank Corp. in Japan, has set up an internet holding company in Korea because of the optimistic prospects for the online market. The new company, Softbank Holdings in Korea (SBHK), will expand operations through its control of Yahoo Korea. SBHK has already joined to set up E*Trade Korea with LG Securities in a market for cyber stock trading in Korea. Furthermore, Son will establish a venture capital company to invest in local venture firms.

Setting up financial holding companies

The establishment of FHCs has been pursued by many major commercial banks and financially oriented groups. Commercial banks such as Hanvit, Hana, Shinhan, Kookmin and Korea Exchange Bank, are preparing to set up a FHC in order to cope with new changes in the financial industry. The major changes include the onset of universal banking, the complete opening of the financial market to foreign financial institutions, and the second round of financial sector restructuring. Although banks have operated various financial affiliates without maximizing the synergy effect and minimizing costs, they will transform themselves into universal financial groups offering one-stop financial service to customers.

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The government is moving to ease regulations on newly established financial holding companies to promote their positive aspects. Since the current laws on holding companies are strict, the government is lifting some of the harsh requirements. In Table 2, comparisons between the Fair Trade Act on holding companies and new possible laws covering FHCs, are summarized in detail.

In addition to changes in the Fair Trade Act, current requirements for banks to have a minimum capital of 100 billion won and 25 billion won for regional banks under the Banking Act may be revised, based on the FHC's number of operations and financial institutions currently under its wing. The Ministry of Finance may present its proposal for the envisaged new law to the National Assembly this June after

Table 2. Plausible Changes in New Law Governing FHCs

Current Monopoly Regulation and Fair Trade Act on Holding Companies	Possible Changes in New Law on Financial Holding Companies
- prohibits pyramid-ownership structures	- allows pyramid-ownership structures whereby subsidiaries of FHCs are permitted to own their own subsidiaries
- companies must have a debt-to-equity ratio of less than 100 percent	- eases the debt-to-equity ratios for FHCs so that they can exceed the current ceiling of 100 percent
- applies the four percent limit on ownership of commercial banks	- lifts the four percent limit on bank ownership for business groups specializing in finance - lifts the limit for FHCs that do not include a bank in its operations
- FHCs must have more than 50% ownership of affiliates	- Same
- prohibits simultaneous holding of financial and non-financial companies	- Same

talking with the Fair Trade Commission (FTC) and the Financial Supervisory Commission (FSC).

Many positive effects are expected

To the extent that the holding company system is an efficient corporate system, it is expected that many changes will take place in business. For example, M&As between two holding companies are likely to be much easier and less reluctant than ever before. That is, restructuring within firms will proceed much more smoothly because of streamlined corporate structures.

The government's permission for establishing holding companies will have many positive effects on the economy.

Since a firm is often compared to an organic body that can easily adapt to changes in environment, the government's permission for establishing holding companies will have many positive effects on the economy. Especially, in a world where drastic changes in industry are occurring very rapidly, the regulatory changes will offer Korean corporations many new options for change. **VIP**